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China had a heaven-sent opportunity this week to improve relations with America, and fluffed it ... More on this week's lead article

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Business this week

Apr 5th 2001
From The Economist print edition

Flying high

Boeing is shifting its competitive emphasis from size to speed. Rather than trying to match **Airbus**'s double-decker, the A380, with another super-jumbo, the American aerospace giant will develop a long-range jet capable of reaching 95% of the speed of sound.

Britain's plan to reform **Railtrack**, the company that owns the track and the stations, hit the stockmarket with a thud. The company's shares fell by 17% on April 2nd, when investors learned that Railtrack would have to give up its stake in the second phase of the Channel rail tunnel.

See article: Railtrack's troubles

Despite weakness among Detroit's Big Three car makers, **American car sales** were stronger than expected in March. BMW, Honda, Lexus and Audi all reported volume gains of between 1.4% and 24% compared with March 2000.

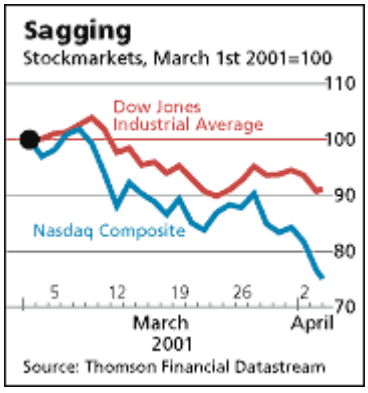
The car makers behind **Formula One motor racing** said they would form a rival championship. They are worried by the involvement of EM.TV and Kirch, two German media groups, in Formula One.

Russian competition officials gave **Russian Aluminum**, a consortium that has become the world's second-biggest aluminium producer, their stamp of approval. A lawsuit filed in America claims that principals of the new company, which accounts for 70% of Russia's annual production, used dirty tricks and racketeering to corner the market.

Germany's **Energie Baden-Württemberg**, a quarter of which was recently bought by **Electricité de France**, will soon own half of **Ferroatlantica**, a Spanish energy and metals concern. With that stake in hand, the German company will seek Spain's permission to buy **Hidroelectrica del Cantabrico**, the country's fourth-biggest generator.

How low can you go

Global stockmarkets found yet another cliff to jump from as American high-tech companies issued new profit warnings. The Dow Jones Industrial Average lost nearly 3% on the week, while the Nasdaq Composite plummeted by over 10%. Frankfurt, London and Paris joined Wall Street's dive.



Reuters, a business-information group, confirmed that it would offer up to 14.1% of its electronic stock exchange, **Instinet**, to the public via the Nasdaq market. When reminded of America's shrunken appetite for new equity, the company claimed that the move was strategic and not meant to raise cash.

Shares in **Lucent Technologies**, the former telecoms-equipment making arm of AT&T, tumbled on rumours of a bankruptcy-court filing. The rumours were swiftly denied. But Lucent's shares have fallen by over 90% since hitting a peak in December 1999.

Markdowns in **American Express**'s junk-bond portfolio contributed to reduced expectations for profits this year. Shares in the financial empire slipped 4% on the warning. Amex also forecast further frailty in its credit-card and asset-management businesses.

The **London Stock Exchange** is thinking of leaving the City, where it has been for 200 years, for the open spaces of Canary Wharf. Clara Furse, who heads the LSE, also plans to take the exchange fully public this year after completing its demutualisation.

Please hold the line

Klaus Esser, the former chief of **Mannesmann**, denied doing anything untoward in allowing the German telecoms firm to be bought by **Vodafone**, a British mobile telephony company. Mr Esser received DM60m ($30m) in severance pay after Vodafone beat Vivendi, the French conglomerate whose chairman is suing Mr Esser for defamation, to the prize.

See article: Esser v Messier

The troubled **BT** is in talks to sell Yell, its yellow-pages business, to a private-equity consortium for nearly *euro*5 billion ($5.4 billion). BT is saddled with debts of over $40 billion.

Telecom Italia tried to please shareholders by offering to cut the price of voting rights in advance of a buyback worth *euro*10.8 billion ($9.7 billion). The company lowered the cost of converting saving shares to voting shares by roughly one-fifth, but it also reduced the majority needed to approve the plan from 80% to 60% of savings shares.

By selling its stake in Hong Kong's Pacific Century CyberWorks, **Cable and Wireless** added $1.5 billion to its acquisitions funds. The British telecoms company is also to sell its share of Singapore's MobileOne for $133m, bringing its war-chest to about $10 billion.

American telecoms regulators are poised to clear **Deutsche Telekom**'s $26 billion acquisition of **Voicestream**, a mobile-telephone operator, despite some opposition to the deal in Congress.

Running for cover

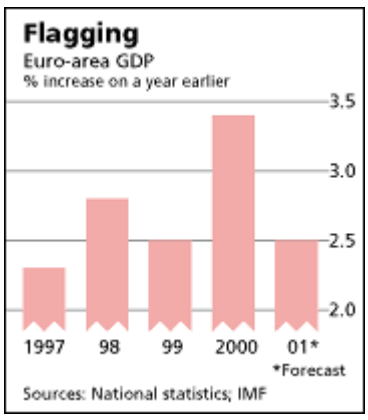
Shareholders of **American General**, an insurer, reacted with glee after **AIG**, an American insurance giant, moved to pre-empt an unpopular buy-out by **Prudential**, a British insurer, with a tender offer worth $24.6 billion. The news lifted Prudential's share price, because AIG is expected to win.

Germany's **Dresdner Bank** accepted a takeover offer worth *euro*22.4 billion ($20 billion) from **Allianz**, the country's insurance leviathan. The new giant will manage *euro*1 trillion in assets. There is talk also of an Allianz buying spree in America and Asia, and of other bank-insurance mergers in Europe.

See article: The revolution in German finance

Horst Köhler, managing director of the **International Monetary Fund**, said his group had slashed its prediction for growth in the **euro area's GDP** from 3.4% to 2.5% this year. The Bank of England, as expected, cuts its base rate a quarter point to 5.5%.

See article: Interest rates



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The world this week

Apr 5th 2001
From The Economist print edition

Face-off

China and the United States exchanged words after an **American spy plane** and a Chinese fighter jet collided. The fighter crashed; the American aircraft, badly damaged, landed in China's Hainan Island. The Americans demanded the return of their aircraft, packed with secret equipment, and of its crew of 24. China held on to both and demanded an apology. All it got was "regret" for the Chinese pilot's presumed death. Not enough, said China.

See article: Bush v China

Delhi came almost to a standstill when **India**'s Supreme Court ordered polluting buses off the streets.

See article: Transport chaos in Delhi

India lifted quantitative restraints on 715 categories of **imports**. But huge tariffs—some actually increased—and other barriers will remain.

See article: Trade barriers

The Supreme Court of the **Philippines** rejected a claim by Joseph Estrada that he was still the country's president, and therefore immune from prosecution.

To judgment

Reuters

Yugoslavia's ex-president, **Slobodan Milosevic**, was arrested, but only after a gun-battle with his heavily armed bodyguards. He is to be tried, in Yugoslavia, for corruption. From The Hague, the UN's international tribunal for war crimes in ex-Yugoslavia called for him to be sent straight there. Not so, said the EU: give Yugoslavia first bite.

See article: The Balkans after Milosevic

Greece's foreign minister, visiting Ankara, proposed that **Greece and Turkey** should both cut military spending.

See article: Greece eases up on defence

In **Germany**, the Constitutional Court decided that workers with children could be allowed to contribute less towards old-age support than childless ones. The argument: the children will be paying taxes when their parents are retired. *Ach so*, snorted the childless.

See article: Childless Germans must pay more tax

Russia's Kremlin-friendly gas (and much else) company, **Gazprom**, took control of NTV, the last national independent television channel. A menace to free reporting, claimed its angry journalists, who struck in protest.

See article: Mixed messages from Russia

Britain recorded its 1,000th case of **foot-and-mouth** disease. Because of the farm crisis, the British

government postponed local elections—and, in practice, the general election. Likely new date for both: June 7th.

See article: Bagehot: The majority doesn't matter

Hard on soft money

The United States Senate passed a **campaign-finance reform** bill, banning soft-money (unregulated) contributions to political parties but raising the limits on individual donations. It was unclear whether the House would follow suit and, if so, whether President George Bush would sign the bill or veto it.

See article: What McCain-Feingold means

Mr Bush sent Congress his $1.95 trillion **budget**, including tax cuts that will supposedly amount to $1.6 trillion over ten years. The Senate voted to redirect $450 billion of this towards education and paying down the national debt. Some Republicans hinted that their defection might prove to be permanent.

See article: The tax cut meets Congress

A European Union mission seeking to persuade the Bush administration to draw back from its public abandonment of the **Kyoto protocol** on climate-change went home empty-handed. The EU said it would go ahead on climate change without the United States, if it had to.

See article: Is the Kyoto treaty dead?

The **Massachusetts Institute of Technology** said it would put most of its course material on the Internet, free.

The city of San Diego, in California, banned any use of the word **"minority"** in its official documents and discussions, saying it implied inferiority. Whites are now a minority in California.

See article: Lexington: California's new complexion

Mexico's President Vicente Fox sent to Congress draft legislation designed to raise $14 billion in new revenues, though cutting the top rate of corporate and personal tax from 40% to 32%.

Colombia moved closer to a second set of peace talks, this time with the lesser of its two big guerrilla groups, the ELN. The army ended a seven-week operation in a proposed haven for the guerrillas in the north of the country.

See article: Colombia nears talks with the ELN

Campaigning ended in **Peru**'s second presidential election in a year. Opinion polls put Alejandro Toledo, a centre-left economist, ahead, but short of the outright majority needed to avoid a run-off.

EPA

See article: Peru's muddy election

Domingo Cavallo, the new economy minister of **Argentina**, told bankers in New York that his country would not require fresh international aid to meet its debt payments.

War, war, jaw, jaw

Tentative **Israeli-Palestinian** talks began after a violent week in which

EPA

Israel's helicopters bombarded Gaza, its tanks shelled Bethlehem, and its forces assassinated an Islamist militant. Shimon Peres, Israel's foreign minister, met two senior Palestinians in Athens, and the two sides' security chiefs met in Israel—after which the Palestinians were fired on by Israeli troops as they returned home.

See article: Israeli-Palestinian violence intensifies

The World Food Programme said that 3m people will need help in **Sudan** because of drought and war.

Armed UN units began to arrive in **Congo**. Eventually, 2,500 armed peacekeepers will support the 500 unarmed observers monitoring the disengagement agreement. As part of this accord, Zimbabwe withdrew 700 of its troops from the front line.

A rebel commander in **Sierra Leone** claimed that his RUF movement was all for peace and would let the UN into the areas it controlled. According to Human Rights Watch, the rebels were still assaulting and robbing refugees as they returned to their homes from Guinea.

See article: Sierra Leone's spreading war

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Seeing red

Apr 5th 2001
From The Economist print edition

IF AMERICA and China had wanted to test how their relations might play out as self-confessed “strategic competitors” rather than once-billed “strategic partners”, neither would have chosen to do it now, just days before America is to decide what new weapons it will sell to Taiwan, which China claims as its own. Barely two weeks ago George Bush and China’s foreign-policy mandarin, Qian Qichen, were stressing their determination to manage one of the world’s most sensitive relationships as carefully as their differences—over human rights and missile defences, as well as Taiwan and much else—would allow. But the collision between a Chinese fighter and a lumbering, unarmed American spy plane over what everyone but China regards as international waters could put paid to that. The incident may have started as an accident, but now—with the situation far from resolved as *The Economist* went to press—its handling must be assumed to be deliberate. So far, China is failing the test.

It was probably always expecting too much to think that the Chinese would do what Mr Bush asked and return immediately both the crew of 24 Americans and their aircraft, which had been forced to make an emergency landing on China’s Hainan island. Nothing in bureaucratic China, especially when it involves foreigners, gets sorted out quickly and, to be fair, it is hard to imagine the Americans sending back a spy plane by return had they been the recipients. Yet here was a—literally, heaven-sent—chance for China to improve prickly relations with America at a super-sensitive moment.

Instead, China’s slowness in dealing with the plane and crew, plus the shrill tone of its officials, starts to look more and more like a deliberate attempt to pick a fight with America. The authorities have not so far been busing in students to hurl stones at the American embassy, as they did after NATO’s mistaken bombing of the Chinese embassy in Belgrade in 1999. But Chinese officials have—implausibly—insisted that America is all to blame, demanded a formal apology and, most dangerously, implied that they may hold on to the aircrew, pending “investigations”.

So what is China playing at? Odd as it may seem, given that China is a Communist country, one problem for its leaders is public opinion. Although some American China-watchers have been wringing their hands at Mr Bush’s—more realistic—talk of China as a competitor and potential rival rather than a partner, China’s state-controlled media have for some time been lambasting America, not just as a rival to China’s growing regional ambitions, but as enemy-in-chief. Having spouted such cold-warlike rhetoric, China’s leaders have left themselves less room for manoeuvre in an unexpected tight spot than some of them might now wish.

All the more so at a time when China’s elderly bosses are trying to parcel out influence among their protégés ahead of next year’s party congress, when power is to be passed to some less antique officials. The Chinese people have no say over this succession struggle, but China’s generals have plenty. Still smarting over the Belgrade bombing, fearful that America’s plans for missile defences could undermine China’s small (though growing) nuclear arsenal and deeply resentful of the protective American arm around Taiwan, they may well be tempted to try to use the aircraft incident to strengthen their bargaining hand—especially over arms sales to Taiwan. China’s president, Jiang Zemin, who needs military support in his political battles, may be loth to stop them.

That would be folly indeed. Any whiff of a threat to hold the aircrew “hostage” in an attempt to influence Mr Bush’s decision over arms sales would backfire disastrously. So far America has insisted, rightly, that the two issues should be dealt with separately. If China now provocatively links them, Mr Bush will come under extreme congressional pressure to sell Taiwan the ultra-sophisticated weapons, including warships with state-of-the-art Aegis battle-management radar systems, that China’s leaders have been lobbying so hard against. Moreover, the sort of constructive dialogue on a wide range of issues that the leaders of both countries claim they want would be off before it had started.

So much to lose

For once, rather than starting out by insisting that for China to save face and “win”, everyone else must lose, China would have done better to reflect on the stake it has in its broader relations with America. Bilateral trade last year was worth at least $75 billion, the vast surplus of it in China’s favour. China is hoping to capitalise on American business interest in its economy to secure more flexible terms for its entry into the World Trade Organisation, to drum up support to counter congressional criticism of its poor human-rights record, and to win backing to bring the 2008 Olympics to Beijing.

China also wants more consultation with America over its plans for missile defences and their implications for Taiwan. Until now, Mr Bush has been careful to say that any defences he may propose will aim to counter any missile threats posed by such countries as Iran, Iraq or North Korea, not undermine China’s nuclear deterrent. His officials have also pointed out that, although America is opposed to the use of force to settle the issue of the renegade province, it does not support an independent Taiwan. There is the basis here for a constructive dialogue, if a difficult one. But does China want it?

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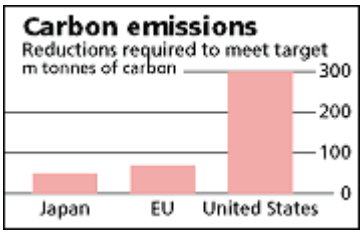
Rage over global warming

Apr 5th 2001
From The Economist print edition

The Kyoto agreement was flawed—but the Bush administration must heed the case for action on greenhouse gases



MANY Americans would have been startled to see the way Europe's press covered last week's statements from the Bush administration about the Kyoto agreement on global warming. When Christie Whitman, head of the Environmental Protection Agency, said that the agreement was "effectively dead", they might have supposed she was stating the obvious—given George Bush's opposition to the treaty throughout his election campaign, and the fact that the Senate (which would have had to ratify it before it could take effect) passed a resolution denouncing the plan by an adequate margin of 95-0. Yet the remark, and later amplifications, were greeted abroad with astonishment and outrage.

One fairly serious British newspaper devoted most of its front article to the story. A photograph of the president, caught in a moment when his expression resembled that of a rabid dog, was surmounted by the headline, "George Bush, Polluter of the Free World". This was not typical, however: most papers in Britain and around the world could not sustain that degree of analytical detachment. Most were really angry.

Perhaps they were right to be—even if they were wrong to be surprised. It took years to come up with the Kyoto targets for reductions in greenhouse gases. The Clinton administration took part in all good faith; the treaty was duly signed. That hard work is to be thrown away, at horrible cost to the environment, to gratify the new president's contempt for environmental concerns, to feed America's gluttonous appetite for energy, and to hell with the consequences. Is this not a fair summary of the position?

Far from it. America had two good reasons to reject the Kyoto accord as it stands. One is that the target to which Mr Clinton committed the United States—a reduction in greenhouse-gas emissions by the end of this decade of 7% below a 1990 benchmark—was almost literally unachievable when the deal was done, and is even more clearly so now. Today, the target implies a cut in emissions of maybe 30%, relative to trend, in less than ten years: it could not be done except at ruinous cost, and perhaps not even then.

Second, the approach of the existing agreement—abrupt reductions in emissions in the short term, and no commitments yet agreed for more distant years—is not well suited to the challenge of global warming. Better would be a longer-term plan, based on milder reductions at the start followed by more demanding targets farther out—targets that encompass, in that more distant future, the developing countries that will eventually be big contributors to the problem. This extended profile is important. It allows flexibility in responding to changes in the science of global warming. It also allows firms to switch to processes that economise on emissions of greenhouse gases as existing technologies wear out, rather than obliging them to scrap equipment before its time. The difference this makes in lower costs is enormous; the difference it makes to eventual abatement of the stock of greenhouse gases is zero. Indeed, because this route is easier, it is more likely to be followed; it is more likely, that is, to succeed.

Constructive engagement

Will Mr Bush propose changes of this kind to the Kyoto framework, or simply walk away? If the latter, foreigners' rage will begin to be justified. Contrary to what Mr Bush and some advisers have said in recent days, a firm scientific consensus now holds that man-made global warming is a problem which must be addressed. In this, America's participation will be vital, and its leadership most desirable. The Kyoto process does need to be reformed—something that European intransigence, in large measure, has prevented up to now—or else a new approach must be proposed to take its place (see article). Mr Bush needs to champion one or other alternative.

For America to withdraw its attention from the issue altogether would be inexcusable. Its rejection of the Kyoto targets in their present form is not merely excusable, it is right.

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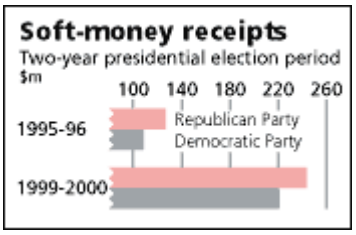
Goodbye, soft money

Apr 5th 2001
From The Economist print edition

McCain-Feingold is a good start. Now, please, do even better

WHEN the United States Senate passes the boldest campaign-finance reform for 27 years, it would be churlish not to celebrate. All is not signed and sealed—the House promises a fight, and George Bush may exercise his veto—but hats off, all the same. Well done to Senators John McCain and Russ Feingold, who had failed four times in five years to get this far, but never stopped trying. Well done, too, to those senators who managed to repent of their past sins and take the steep path of self-restraint—at least until their legal advisers have worked out how they can get round it.



McCain-Feingold does four things. First, it bans “soft money”, the unregulated donations made ostensibly to political parties but, in fact, disbursed to candidates, which accounted for nearly $500m in the last election cycle. Second, it restricts the use before elections of “issue ads”, again supposedly generic but, in fact, helpful to specific candidates. Third, it raises the limit on individual contributions to candidates (“hard money”) from $1,000 to $2,000 a year, to make up for the soft-money opportunities they have lost; and, lastly, it requires television broadcasters to offer candidates cheaper rates for their campaign commercials.

All this is good. But alas, it also looks like a wall of sand against an incoming tide. Already, it seems clear that the ban on soft-money contributions to the parties will hugely strengthen those villains of the past, the political action committees (PACs), which bundle together hard-money donations on behalf of special interests such as tree-huggers and gun-owners. If McCain-Feingold runs into trouble in the House, as looks likely, it will be because its opponents are playing the PAC card, and with some cause.

Cutting the demand side

The painful fact is that nothing will keep money, galumptious amounts of it, from pouring through America’s elections. People want to help the politicians whose ideas they approve of. More venally, they also want to help the men and women who might do them favours if elected. The urge is as old as sex, and almost as much fun for its practitioners. McCain-Feingold gets rid of some of the most blatant devices, and that is well worth doing. But as Mr McCain himself often acknowledges, curbs on giving money are bound to fail. As with sex, people will only dream all the more about doing it.

Tackling the supply side, in short, is not the best answer. A bolder idea would be to forget that altogether. Abolish all restrictions on any sort of giving, by individuals or by groups; simply insist that the world knows who made the contribution, and to whom. By all means let Gusher Oil Inc give $1m to Senator Spigot’s re-election campaign, but publish the fact; and then, when Senator Spigot votes down a petrol tax, let voters draw their own conclusions.

Concentrate instead on demand. America’s campaign-finance system is a runaway money-train not because people give money, but because candidates demand it. They can never get enough; most of them start campaigning for re-election the moment they arrive in Washington. If campaigns cost less, supply would shrink accordingly.

Two reforms would help here. First, bring in public funding for candidates who are willing to forgo private contributions. America has never liked the idea of federal involvement in elections, below the presidential race. But McCain-Feingold was amended to allow federal help for candidates facing wealthy challengers, and the principle could be extended. Those who think this is “socialism” should, perhaps, try it.

Second, in order not to lock the government into ever-higher spending, reduce the cost of television time—the most burdensome component of campaigns—by requiring broadcasters to offer free time as a condition of getting a licence. They’ll jib, of course, and mutter about free speech. But the airwaves are a

public resource; those lucky enough to profit from them should be prepared to give something back.

Let's not kid ourselves; all this, too, would not produce a perfect system. Politics is a grubby business. But it would be another big step, after McCain-Feingold's brave start, towards more open and honest campaigns. Would the same two gentlemen care to volunteer?

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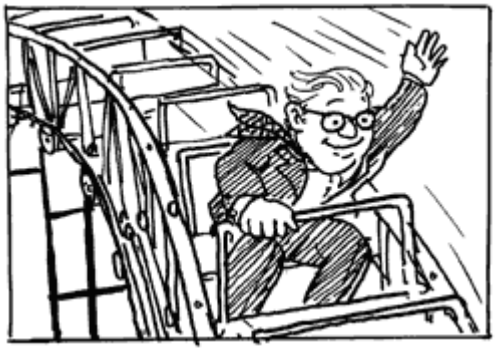
Managing the downturn

Apr 5th 2001
From The Economist print edition

The real test of a company's strength is how it handles bad times



MOST corporate managers in the United States doubtless feel that living through the longest economic upswing ever experienced was fun while it lasted. Certainly, it was more enjoyable than what is now following: a long, maybe very long, period of retrenchment. Launching new products, opening new offices and hiring new staff can be hard work, but it is much more pleasant than hacking and sacking. Yet the way that a company deals with a downturn is not only the best proof of its bosses' mettle; it may also determine how well a business does when things improve.

One problem is that the sheer length of the upswing means that most of today's chief executives were, at best, middle managers last time around. Indeed, some of today's most high-profile companies (Cisco Systems, Vodafone, AOL) are essentially children of the good years. Unlike executives running many European companies in the 1990s, their managers have known nothing but growth. Almost no executives who are under the age of 40 have any first-hand experience of what it is like to manage through the downswing in the business cycle. And, given that the fastest-growing businesses have tended to have young talent at the top, this bodes ill.

Of course, many of the skills needed on the way up are valuable on the way down too. A company that is badly run in boom times will not do any better in a slump. But some of the chief executives who were lionised over the past couple of years now look decidedly tarnished. Such pin-ups of the business magazines as Jeff Bezos of Amazon, Carly Fiorina of Hewlett-Packard or Michael Armstrong of AT&T have lost much of their credibility as their share prices have tanked. Who now lauds Hong Kong's Richard Li, of Pacific Century Cyberworks, or Japan's Masayoshi Son, of Softbank?

What such bosses are finding is that steering a company through bad times is simply a lot harder than managing in a boom (see article). The reason is that growth hides a multitude of mistakes. Who, a year ago, asked searching questions about the earnings (or lack of them) at any business with an "e" at the start of its name? Make a dud acquisition and, in good times, some sucker will pay handsomely to take it off your hands; make a few bad hires and most will soon leave for other jobs. It does not work like this in a recession, when strategic moves that looked brilliantly bold can suddenly seem fearfully foolish. In a downturn, managers need to be warier of risk, knowing that one mistake can be a killer.

Because a downturn is less forgiving than a boom, it will test managers' comfortable assumptions. Does outsourcing really give flexibility, for instance, or does it trap a company in a contract that is harder to break than it would be to shed homegrown labour? A downturn also forces companies to make tough choices that are easy to postpone when the sun is shining. Unprofitable plants are put out of their misery; unsuccessful products jettisoned. Britain's Marks and Spencer has decided at long last to shut its barely profitable European stores and sell Brooks Bros in the United States; Sweden's Ericsson has decided to get out of making mobile-telephone handsets and subcontract the work instead.

The balance is hard to strike, though. In the coming months, managers will need to make plenty of such harsh decisions, but without jeopardising the potential for future growth. Companies often go for quick savings by cutting research or training. In fact, such spending takes time to build up. The more they cut now, the longer they will suffer.

Downturns may be harder for managers, but they bring benefits too. Those will go mainly to companies that did not overextend themselves during the boom. The temptation to splurge on a new venture or technology is always greatest when a boom is peaking; and the dotcom mania provided lots of opportunities to indulge. The companies that resisted the lure will now be financially strong enough to pick up the bargains that always appear when markets collapse. Watch to see which companies buy those hideously expensive licences for third-generation mobile-telephone services when some of their

original purchasers flounder.

Opportunity knocks

Some of the bargains will be human. A recession tips the balance between employer and employee in the company's favour. Hiring and keeping good people is easier when new jobs are scarce. So a temporary truce breaks out in the war for talent—although battle will recommence the moment the economy picks up. This will be a good year for confident companies to invest in an armoury of high-quality staff.

There will be bargains, too, in unwanted plant. The flip-side of America's overinvestment in the past few years will be plenty of secondhand servers and underused cable capacity for solvent businesses to snap up at rock-bottom prices. When the good times return, those low prices will powerfully stimulate demand.

The companies that can afford to take advantage of these opportunities will be wonderfully placed to take advantage of the recovery. The periods when companies can make serious money tend to be brief, and it takes a quick and flexible response to make the most of them. Managing in an upturn is relatively easy. What really determines a company's long-term strength will be the way it copes when the rain begins.

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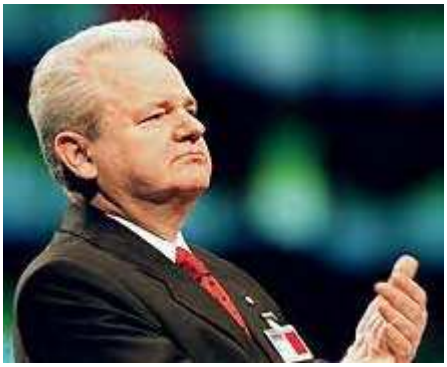
Milosevic's trial

Apr 5th 2001
From The Economist print edition

It should be for war crimes, before the Hague court, whatever charges he may also face in Yugoslavia

EPA



IF HISTORY is made by men, and not just ineluctable forces, then Slobodan Milosevic can claim a starring role. No single person has done as much to shape the history of the Balkans in the past dozen years, and no single person has as much to answer for in the court of historical judgment. The verdict of history, however, is too remote for those affected by his actions. They want, and deserve, justice. In itself, the arrest of Mr Milosevic last Sunday, welcome though it is, will bring at best only partial justice. The charges he faces in Yugoslavia—misuse of power, corruption and perhaps incitement of others to resist his arrest—concern not much more than the epiphenomena of his rule. The graver accusations of war crimes that so many people want to see him answer appear on the charge sheet only of the international court in The Hague. That is the court that should try him next.

Not all Yugoslavs agree. Vojislav Kostunica, the man who succeeded Mr Milosevic as president of Yugoslavia, strongly opposes any suggestion that his predecessor should be sent to The Hague, and since he is a long-standing democrat in a not very democratic part of the world, his views deserve a hearing. Mr Kostunica says the Hague court is a political affair, biased against Serbs, and of dubious legitimacy. Moreover, Serbia, he says, is politically fragile. It needs time to form its own democratic habits and establish the rule of law. It does not need chivvying from outsiders. Implicitly, he seems to say, "Leave us alone while we deal with our tyrant our way."

In truth, the Hague court looks remarkably unbiased. True, it has not pursued any NATO leaders for their part in the Kosovo campaign two years ago, but though the legality of NATO's action always looked questionable, few international lawyers believe that it merited war-crimes charges. The court is, however, investigating possible atrocities committed by the Kosovo Liberation Army. And it has successfully prosecuted both Croats and Muslims, as well as Serbs, for crimes in the earlier, Bosnian war. The tribunal, like its counterpart for Rwanda, is emphatically not a victors' court. It was set up by the UN Security Council and its chief prosecutor, Carla Del Ponte, is a Swiss. In short, Mr Kostunica has no good reason to believe Mr Milosevic would not get a fair trial.

The president's argument that the Yugoslavs should be left to deal with Mr Milosevic in their own way is just as flawed. Yugoslavia is indeed a fragile polity. It has taken American prodding, coupled with the threat of withholding aid, to bring about the arrest of Mr Milosevic. So there is every reason to wonder whether the Yugoslavs have the capacity, either political or judicial, now to mount a proper trial of Mr Milosevic. That, however, is an argument for someone else doing it.

The worry is that, even if war-crimes charges were brought against Mr Milosevic by the Yugoslavs—and there is still no sign of that happening—the trial would be inadequate. The charges would probably not be the ones that people outside Yugoslavia believe should be brought, and the protection of witnesses would present formidable difficulties. Meanwhile, Croats and Bosnian Muslims might reasonably object that their co-operation with the Hague court was not being matched by the Serbs. And the court itself would be vulnerable to the criticism that it was pursuing small fry while the biggest fish had escaped it.

Natural justice demands that those ultimately responsible should stand trial for any crimes committed, however willingly, at their behest. That, incidentally, suggests that Milan Milutinovic, the current president of Serbia, should also be sent to The Hague; like Mr Milosevic, he has been charged by the court with killing 340 ethnic Albanians and expelling 740,000 others. But natural justice is not the only reason for a trial. Unless the history-makers are put in court and made to answer for their actions, it will be difficult to establish not just who was responsible for what, but how it all came about.

And the water in which the big fish swim

At present most Serbs, for all their welcome readiness to seek a more democratic future, still see themselves as victims and remain unwilling to confront their complicity in Mr Milosevic's appalling rule. Yet the enormities of the 1990s were not the work of one man alone, however great his responsibility. If the Balkans are ever to achieve any kind of harmony (see article), Serbia needs to go through something akin to the denazification that took place in Germany after the second world war, and Serbs need to recognise, with honesty, their part in the horrors. After all, it was only last September that two Serb voters in five gave their support to the man so many now revile. A trial is certainly needed, for the sake both of justice and of the hope that history will never be repeated. But it must be a trial before the Hague court.

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The Middle East's angry men

Apr 5th 2001
From The Economist print edition

Ariel Sharon promised that he would not talk to the Palestinian leaders until they had called off their uprising. Fortunately, he may be having second thoughts

Reuters

IN RECENT weeks, the Israeli government and the Palestinian Authority, guided by no discernible policy, have appeared to be racing towards disaster. Now they are talking. That is the very minimum needed if the threat of even more violent confrontation is to be lifted from the Middle East.

Ariel Sharon was elected Israel's prime minister in February on the double promise that he would make his people safer, and would not talk to the Palestinians until they were. With strong support for this stand, his army set about bringing the Palestinian leaders to heel by means that included bombing from helicopters, shelling from tanks, kidnapping senior security men and killing suspected terrorists. Unremarkably, the uprising continued, and caused Israel pain: in the month since Mr Sharon took office, soldiers, settlers and children have been killed by Palestinian gunfire and suicide-bombers. Recognising reality, and under quiet pressure from America, the prime minister has been obliged to start rethinking the second half of his promise. This week, Shimon Peres, Israel's foreign minister, met two senior Palestinians in Athens, and top security men had a get-together in Israel, though the firing continued on the Palestinians' return journey.

What are they talking about? At this stage, the Palestinians are probably even shorter of road maps than the Israelis. All they know is what they will not do, which is meekly to give up. Yet the six-month *intifada*, an uprising that started almost accidentally after demonstrators outside al-Aqsa mosque in Jerusalem were killed by the Israeli army, never had the spontaneous, widespread support of the earlier uprising in the late 1980s. To any objective observer, the pain it has caused the Palestinians—nearly 400 people killed, a stifling siege economy—vastly outweighs anything the protests can be said to have achieved.

The *intifada*'s leaders, mainly members of Yasser Arafat's Fatah movement, have set their sights, and their guns, at the army-protected settlers who compete for the hills and valleys that may one day be a Palestinian state.They want to demonstrate to Israelis that a quiet life is not compatible with the settlements' unceasing expansion, and the restrictions and fears this means for Palestinians who live nearby. And though they may well fail in this aim, they will not easily be pummelled or punished into submission.

Nor are they in any mood to reject Mr Arafat, who is now the man Israelis love to hate (see article). He is widely seen as villain-in-chief, the stubborn myope who flung Ehud Barak's over-generous offer back in his face, the wily double-dealer who refuses to rein in his gunmen. Some Israelis are even suggesting that Mr Arafat's departure has become the necessary precondition for any sort of accord. Indeed, his demonisation has begun to match that of Saddam Hussein.

West Bankers and Gazans do not care much for Mr Arafat either. Even with all the disadvantages of Israel's over-lordship, he is not a good president of his bits and bobs of territory: he travels round the world to meet important people while his administration grows fat on corruption. No doubt, when Palestine eventually becomes an independent country, its people will choose a new, more democratic president. But Mr Arafat's genius has been to survive as a resistance leader who, against all odds, keeps resistance alive. And, these days, it is as a resistance leader that the Palestinians, within the occupied territories and outside, look up to him.

The one conclusion that seems indisputable is that the situation will worsen unless the Israelis and Palestinians can talk their way out of their blood-stained cul-de-sac. For the violence, on both sides, to come to an end, negotiation has not only to be started but steadily pursued. Moreover, it has to go well beyond Israel's simple desire to instruct Mr Arafat to call off the uprising and start rearresting suspected

terrorists. On the other hand, it cannot be over-ambitious: although the Palestinians still speak in terms of a permanent settlement, all hope of settling those intractable “final issues” has, for now, evaporated. The aim, at this stage, should be the more modest, but still immensely difficult, one of a relatively decent, relatively long-term, modus vivendi.

Time for warrior and guerrilla to trade

The talks need not be formal. But, under some guise or other, the old warrior, Mr Sharon, has to talk to the old guerrilla leader, Mr Arafat. Certainly, Mr Arafat has to call off his gunmen, and restrain Islamist terrorists. But to win the relative quiet and security they crave, the Israelis too have to contribute to peace. Could Mr Sharon, in return for full security co-operation, promise a further withdrawal in the West Bank and a freezing of settlement expansion? It would be dreadfully hard for him, but he should. And perhaps he could.

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Letters

Apr 5th 2001
From The Economist print edition

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Election hopes

SIR—You assert that I have "dashed" the hopes of the people of Kosovo by "ruling out" elections this year ("War in the Balkans, again?", March 24th). On the contrary, since assuming my post here in January, I have said continuously that the United Nations Mission in Kosovo (UNMIK) and the Organisation for Security and Co-operation in Europe plan to hold elections as soon as possible. This is still the case.

Of course, the exact timing depends on the finalisation of the Legal Framework for Provisional Self-Government in Kosovo. This is progressing steadily and I am convinced that it will be possible to hold Kosovo-wide elections before the end of 2001.

HANS HAEKKERUP
Special representative of the UN secretary-general, UNMIK
Pristina

Staff safety

SIR—Benon Savan may well want to improve the safety of United Nations' field staff, and it is apparent that up-country workers of the NGOs and various aid agencies in Guinea are acutely aware of their vulnerability ("The dangers of trying to help", March 10th). There was, however, a spectacular lack of response to a recent proposal offering subsidised emergency and evacuation assistance from Guinea. The officials in Conakry responsible for formulating contingency plans either have a flawless scheme in situ, or have adopted an "it will be all right on the night" attitude, which unfortunately has rarely been the case.

A couple of the smaller NGOs have shown concern for their personnel, but have found they are constrained by their funding agency from investing in independent escape planning. They have been confused as to whether the American embassy has any plans for recovering personnel from outside the capital, and certainly have received no instructions on action to take in the event of an evacuation. If the UN has concerns about the safety of its personnel it should be exploring all possible options.

MIKE BORLACE
Conakry, Guinea

Panic measures

SIR—It is disheartening to read of the panic measures various bureaucratic politicians are taking with cattle suspected of being infected with foot-and-mouth disease ("Foot, mouth, farm, subsidy", March 17th). In Kenya we suffer such outbreaks from time to time. When this happens, the farm, or farms, infected, and usually the surrounding ones, are put in quarantine. In a month or two when the disease has subsided, quarantine is lifted and life returns to normal. This has been the worldwide treatment for more than 50 years. What has changed in the disease? I venture to say "nothing", so why the thoughtless panic? No human can catch foot-and-mouth, let alone suffer or die from it.

We who have farmed cattle as well as crops must despair of being ruled by such petty-minded civil servants who may well have never visited a farm, let alone mucked out a stable.

H. STUTCHBURY

Nairobi

Short shrift

SIR—The successful Labor candidate in the recent Australian by-election for the Queensland seat of Ryan was Leonie Short, not Bob Tucker ("In full swing", March 24th). Mr Tucker was the unsuccessful Liberal candidate.

You correctly identified Prime Minister John Howard's new goods and services tax as having played a part in the Liberals' loss of this seat. I believe it played a very large part, as the unnecessary complexities and confusion associated with its implementation are impacting not only the "small businessmen" to whom you refer but also others who were previously Mr Howard's "core supporters" such as farmers and self-funded retirees.

JOHN HUGHES
Collaroy Plateau, New South Wales

Zambian privatisation

SIR—In your article on Zambia you say that "foreign donors cheered when 248 out of 280 state-owned firms were privatised. But many of the companies were sold for a song to the government's cronies" ("Glued to the throne", March 17th).

The Zambia Privatisation Agency is an autonomous agency of government. Transparency is enshrined through a number of provisions, including:

•The ZPA board is structured in such a manner that it is very difficult for one person or group to influence or manipulate its decisions. The board is private-sector-led, with only three out of the 12 directors nominated by the government. The chairman and vice-chairman must be chosen from the private-sector representatives. The nine private-sector members are nominated by the professional institutions they represent.
•Statutory reports are tabled before parliament every six months.
•Bids, bidders, bid prices and reason for selecting winning bids are gazetted in the government gazette.
•Each company/unit is sold within the value range certified by an independent valuation undertaken by independent, expert business valuers (eg, Deloitte & Touche, Price Waterhouse, Coopers & Lybrand—as was).
•All sale transactions facilitated by the agency are undertaken by highly qualified, experienced and competent independent negotiating teams appointed by the ZPA board.

Furthermore, politicians are treated on equal terms with any other bidder but must publicly declare their interest prior to bidding—a requirement that has led to a number of disqualifications. There have been several cases where bids by political leaders have failed due to stiff competition from other bidders, or their own inability to raise necessary funding and only six units have been sold to politicians. Please note also that the co-operating partners have continued to support the programme and have expressed their satisfaction with the level of transparency.

In light of the above, we challenge you to provide your readers with transactions which have been sold to government "cronies" and which in your professional judgment have been "sold for a song".

STUART CRUICKSHANK
Chief executive, ZPA
Lusaka

Post mortem

SIR—Your article on St Louis politics and voting scandals notes that "hundreds of registered voters were turned away from polling stations by staff using inaccurate records. So many outraged voters then swamped the courts that a judge ordered the polls to remain open until 10pm—until overruled by an appeals court" ("Mayor's nest", March 3rd).

You did not report that one factor influencing the appeals court decision was that the voter on whose behalf the suit was brought was found, perhaps not surprisingly, to have died nearly a year prior to the

election.

JAMES HEIMER
Houston

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One step forward, one step back

Apr 5th 2001 | BELGRADE, PRISTINA AND SKOPJE
From The Economist print edition

AP

Slobodan Milosevic has been arrested. But in the places where he wreaked havoc, recovery and reconciliation are still hard to achieve

WHEN the police came at last to take Slobodan Milosevic away from his home in Belgrade last weekend, the event was a microcosm of the Serbian strongman's career. It began with blustering threats—"I won't come out alive"—which soon led to a burst of gunfire, some clumsy mistakes by his opponents (in this case, his own government, egged on by the western world) and a period of hectic negotiations, ending in humiliation for himself and those around him, his family and bodyguards.

Although the final rendition of this drama had an element of farce, its earlier performances had tragic consequences for millions of people. As champion of the Serbs for the decade which followed communist Yugoslavia's disintegration, Mr Milosevic fanned the flames of war in Croatia, Bosnia and Kosovo—with horrific consequences in the short term for non-Serbs, and eventually, after a period of war and negotiation, disastrous results for his own people.

In the short term, the ex-tyrant may be charged only with abuse of power and corruption. He is also being investigated for some murky happenings on the Belgrade political scene over the past two years: the disappearance of an ex-president, the assassination of a newspaper editor, attempts to kill an opposition leader. And it looks increasingly likely that he may, sooner or later, have to answer much broader charges of crimes against humanity, at the war-crimes tribunal in The Hague. In his appeal against detention, Mr Milosevic claimed that much of the missing money went to buy arms and ammunition for the Croatian-Serb and Bosnian-Serb armies: an admission which has delighted investigators at the Hague tribunal, who are keen to indict him for crimes in those two republics.

Given his awful record, how did people put up with him for so long? When he was arrested last weekend, only a couple of hundred mostly elderly people demonstrated in his support; but as recently as last September, about 1.9m people, or 40% of the electorate, were still prepared to vote for him.

Among Serbs who have always opposed him, there is a belief that the tyrant, however culpable, was useful to other people, too. During the Bosnian war, he was able to turn himself from warmonger to indispensable peace-broker, a transformation that western governments readily accepted. He fought a war against his fellow nationalist, the late President Franjo Tudjman of Croatia, and then colluded with him in a bid to break up Bosnia. In Kosovo, a province of Serbia where ethnic Albanians are in the majority, campaigners for independence saw clearly that Mr Milosevic's brutal reputation worked to their tactical advantage; a more moderate leadership in Belgrade would have undermined their case.

But Mr Milosevic mostly got away with it because he patented and personified a style of government which, from its practitioners' viewpoint, was a rational response to the upheaval that followed the collapse of communism. In other parts of Central and Eastern Europe, as well as western capitals, the downfall of Marxist-Leninist ideology brought a surge of optimism. The end of the cold war seemed to presage a new European order, in which war was unthinkable and economic development, the rule of law and democracy would reinforce each other in a perfectly virtuous circle.

Those principles had been foreshadowed in the Helsinki Final Act of 1975, in which governments of Eastern and Western Europe, with the blessing of America and Canada, agreed to respect each other's borders while also accepting that human rights were an international issue. With the collapse of the Soviet block, it seemed possible that the ideals of Helsinki would be entrenched in practice as well as theory. The desire of ex-communist countries to join elite western clubs, such as NATO and the European Union, seemed to provide an ideal opportunity for the western world to influence their behaviour: unless they settled their internal and external problems peacefully and lawfully, they could forget about sitting at the top table.

After such high hopes, the resurgence of violent nationalism in the Balkans astonished many western leaders. Bill Clinton spoke for them: how could people who had lived together peacefully for so long suddenly turn on one another in hatred?

In fact, the post-communist variety of ethnic politics—made notorious by Mr Milosevic, but also practised in varying degrees by Croatian, Bosnian-Muslim and ethnic-Albanian power-brokers—is a specific strain of the nationalist virus. It appeared in many places where the Marxist system, with its windy slogans of unity and brotherhood, collapsed suddenly. In former Yugoslavia, as in the Caucasus, many ex-communist leaders found that fanning inter-ethnic passions provided a handy way to maintain their grip on economic and political life. After all, when a nation or ethnic group is "battling for survival", literally or metaphorically, then its leaders can suppress dissent, and shrug off calls for a more open economy and society.

Whenever nationalist rhetoric reaches its logical conclusion—in war, mass deportation and violently imposed ethnic segregation—then this tactic works even better. Political bosses, in close cahoots with criminals and warlords, not only control the civilian economy; they can also rake in the spoils of racketeering, sanctions-busting and looting. Moreover, criminal nationalism on one side of a conflict triggers a similar phenomenon on the other side; a powerful "war party" develops with an interest in sabotaging any attempt to make peace.

The ostentatious wealth of Mr Milosevic's neighbours, in the smart suburb of Belgrade where he was arrested, is a striking, if grotesque, symbol of the handsome rewards that chauvinism tinged with lawlessness can bring to a few. But there is another side to that coin: the miserable life led by hundreds of thousands of Serb refugees from the war zones of Croatia, Bosnia and Kosovo, where Mr Milosevic raised the flag of nationalism but eventually had to cut his losses and run.

Going back to Bosnia

Behind the showy arrest of Mr Milosevic, the western world has also been achieving some quiet tactical victories, especially in parts of Bosnia which have dropped out of the headlines. Because of the horror it endured—a three-year war in which about 2m people, or half the population, were displaced and 100,000 or more people were killed—and also because of the high ambitions of the Dayton peace agreement, sealed in 1995, the country is a sort of litmus test for international policy in the Balkans. Although the high politics of Bosnia remains a terrible mess, there are local signs that it may, after all, be possible to put multi-ethnic states, and communities, together again when they have been torn apart by force.

Reuters

In the hill country round Vitez in central Bosnia, for example, Croat and Muslim communities used to live in a series of concentric circles. They were therefore able to besiege and blockade each other with great cruelty in 1993-94, when those two groups were fighting each other, as well as the Serbs. But over the past two years, thousands of families have settled back into homes from which they were expelled for being in the "wrong" place in ethnic terms.

Even more remarkable is the accelerating pace of return by displaced Muslims to villages in the Serb-held half of Bosnia, the very place where Serb extremists, sponsored by Mr Milosevic, reintroduced the concept of ethnic

cleansing to the vocabulary of modern Europe. In places that were cruelly emptied of non-Serbs in 1992, Muslims are coming back to rebuild their houses, mosques and businesses.

Going home

For the international bureaucracy that oversees Bosnia, backed up by a NATO peacekeeping force, these returns send a powerful political message which goes well beyond the welfare of the 100,000 or more people who have taken the risk of moving back to places where a rival ethnic group is in local control. As aid workers and NATO soldiers have discovered, displaced families are extremely sensitive to changes in the political atmosphere, both local and international. They are prepared to invest enormous effort in reconstructing their old way of life—but only when their political antennae tell them it is safe to do so.

To create these conditions, international bureaucrats and peacekeepers have had to involve themselves in the politics of scores of small Bosnian communities, manoeuvring ingeniously and sometimes deviously to strengthen moderates and isolate extremists. The political forces who opposed them, and did their best to stop the reconstruction of multi-ethnic communities, were often smaller-scale practitioners of the chauvinist politics that Mr Milosevic epitomised.

As long as war prevailed, warlords on every side were able to frighten members of their community into submission, by saying in effect: “Your only hope of survival is to accept our authority, overlook our misdeeds, and carve out a piece of territory in which our tribe, and only our tribe, will be allowed to live.” After the war, their bullying continued. A report by the European Stability Initiative, a Berlin-based think-tank, found that nationalist power-brokers in all three Bosnian communities tried to use control over the police and judiciary “to harass political opponents and returning minorities”, while continuing to enjoy the fruits of black-market trade, especially in fuel, tobacco, alcohol and food.

At their most successful, NATO peacekeepers in the Balkans have been able to face these bullies down. This, in turn, creates a huge change in the public mood and the political atmosphere. People feel safe, and those who have left return.

Intractable Kosovo

But to start rebuilding Bosnia as a multi-ethnic society has taken five years of work, over $5 billion-worth of aid—much of it misdirected—and tens of thouands of soldiers. Inevitably, some western politicians are asking whether it is worth the effort. Harder questions are also being asked about the performance of the two-year-old international protectorate in Kosovo, where a 40,000-strong NATO-led force and a large UN bureaucracy are proving incapable of stamping out crime or re-establishing any kind of inter-communal harmony.

In fairness, the overlords of Kosovo can also point to some achievements—including the mere fact that about 1m ethnic Albanians, who had fled their homes at the height of NATO’s air war against the Serbs, were able to return to the province without suffering any fresh humanitarian disasters in the form of epidemics, hunger or homelessness. Also to the UN’s credit, arguably, is the fact that internecine fighting between various ethnic-Albanian factions has been kept under control; and that local elections were successfully conducted last autumn, with an impressive showing for the moderate political party headed by the Kosovars’ veteran leader, Ibrahim Rugova.

But the creation of a multi-ethnic society in Kosovo, which was supposed to be one of the purposes of NATO’s intervention, still looks an impossible dream. Nearly 200,000 non-Albanians—Serbs, Gypsies and other minorities—left their homes after the Yugoslav army withdrew from the province. Of the 90,000 or so Serbs who remain, more than half live in a strip of land on Kosovo’s northern edge, including the northern part of the town of Mitrovica, from which many Albanians have been forced out. Others lead fearful lives in enclaves of southern and central Kosovo, reliant on NATO protection to go shopping and take children to school.

Compared with Bosnia, the protectors of Kosovo set themselves an even more ambitious—perhaps absurdly ambitious—task. The American-led peace-making effort in Bosnia was based on a sophisticated form of expediency: separate the ethnic groups first (in part, by allowing the parties to fight their way to “realistic” partition lines) and then gradually reintegrate them.

In Kosovo, where pre-war ethnic tensions ran even deeper than they had in Bosnia, and in the immediate aftermath of a short but exceptionally vicious war, an attempt was made to establish inter-ethnic co-existence with no temporary resort to separation. The reason for this was not misplaced idealism, but the realities of Balkan politics. The victorious Kosovars, on whose behalf NATO had waged war, would have objected furiously, then and now, to anything that smacked of “cantonisation” or partition of their province, however temporary.

In the end, a degree of cantonisation occurred anyway, because NATO has chosen not to react strongly to Serb bullying in northern Mitrovica and elsewhere. This, in turn, has weakened NATO’s moral case as it tries to protect Serb civilians in other parts of Kosovo. In an ideal world, the peacekeepers would apply the same principle in Kosovo as they have, however cautiously, in Bosnia. In other words, they would break the bullies’ monopoly over physical security, and thus convince people that enforced racial exclusivity is not their only hope of staying alive.

In a sense, almost the opposite has happened. The local Serb toughs known as “bridge-watchers” who dominate northern Mitrovica can plausibly argue that their tactics, including the expulsion of local Albanians, offer the only guarantee that a few thousand Serbs, at least, can remain in Kosovo.

And in Macedonia...

The international guardians of Kosovo face even bigger problems on the eastern and southern edge of the province, where the pent-up energy and still formidable arsenal of the ethnic Albanians have helped to fuel low-level guerrilla wars in a narrow strip of southern Serbia and, much more seriously, in hitherto peaceful Macedonia.

After a two-week standoff between Macedonian armed forces and ethnic-Albanian rebels from the self-styled National Liberation Army (NLA), that country is still teetering on the brink. Under the watchful eye of envoys from the European Union, negotiations are taking place between representatives of the Slav Macedonian majority and the ethnic-Albanian minority to see whether some peaceful way can be found to meet the political grievances that the NLA has tried to co-opt.

At an everyday level, friendships and business relations between Slav Macedonians and Albanians have come under strain in a way that is ominously reminiscent of Sarajevo in 1992. “People who used to stop and chat to each other will now barely say hallo,” laments Veton Latifi, an ethnic-Albanian journalist. The one bar in Skopje, Macedonia’s capital, that both communities frequent became eerily empty during the recent fighting; only in the past few days has business picked up.

Reuters

Would he rather be protected by a warlord?

While western governments have rushed to reassure Macedonia of their support, Slav Macedonian politicians fulminate bitterly against NATO’s naivety, or worse, in handling the Kosovar Albanians. As they see it, Kosovo’s western rulers have turned a blind eye to drug-trading, gun-running and other illegal activities for the sake of a quiet life; and they blame the rebellion in Macedonia on western laxity, as well as on obscure quarrels within the ethnic-Albanian underworld over the spoils from smuggling across the Kosovo-Macedonia border.

While Slav Macedonians are nervous about the prospect of an independent Kosovo, many reckon the West should have done more to promote economic and political development in the province. If the old demon of criminal nationalism, apparently fading away in other parts of the Balkans, is on the rise in and around Kosovo, it is because a dangerous vacuum arises when a well-armed and resilient people, hardened by war, is denied other outlets for its energy.

Even in Bosnia, the latest news is troubling. A political revolt by Croat extremists has presented Bosnia’s international guardians with one of the biggest challenges to the Dayton agreement, which refashioned the country as a loosely-structured union between a Serb republic and a Croat-Muslim federation.

Enraged by a recent constitutional change, leaders of a hardline Croat party have called for a mass withdrawal by their community from federal and Bosnia-wide institutions. This harks back to the bad old days, when Bosnia’s south-western corner was a Croat-nationalist fief. Wolfgang Petritsch, the Austrian

who represents the outside world in Bosnia, has reacted by dismissing the hardliners' leader, Ante Jelavic, from his position as one of Bosnia's three co-presidents. Mr Jelavic has retaliated by calling on Croats to leave the federal army; several thousand appear to have done so, although they have not taken their weapons with them.

An optimistic interpretation is that this revolt marks the last gasp of extreme nationalism in Bosnia. With the advent of more moderate governments in Serbia and Croatia, and the strong performance by non-nationalists in the Bosnian elections last November, the cause of chauvinism has suffered some heavy defeats; so the behaviour of Mr Jelavic is an act of desperation, not a serious threat to peace. "People like him have lost so many of the levers of real power that they can no longer pose a threat," says Gerald Knaus, an analyst who watches Bosnia closely.

But it might be fairer to say that western policy, in Bosnia and elsewhere, still hangs in the balance. Hardliners have not entirely ceased to hope that the outside world will lose interest in micro-managing their region before stable institutions have been established there. Ironically, the downfall of Mr Milosevic—wrongly assumed by many western politicians to mark the beginning and end of criminal nationalism in the Balkans—may drain the energy available to wrestle with that demon in other places.

Throughout former Yugoslavia, politicians are watching developments in neighbouring republics with anxious interest. If Montenegro, reluctantly linked to Serbia in the rump Yugoslav federation, votes to break away this year, that will raise fresh questions about the status of Kosovo.

Other connections are not so obvious. Srdjan Kerim, Macedonia's thoughtful foreign minister, is keeping a watchful eye on Bosnia. If the Dayton agreement collapses, he says, that could lead to a fresh war over the terms for Bosnia's final disintegration. And if the precedent is established that hitherto unitary states can be broken up by force, then his country and several others will be in deadly danger.

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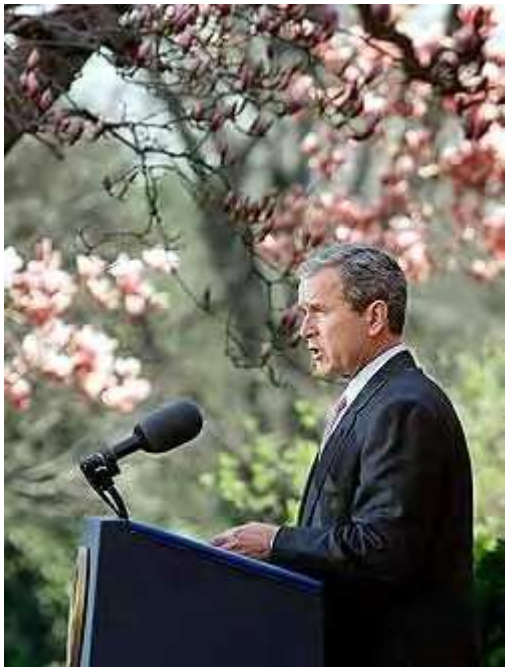
Crashing to earth

Apr 5th 2001 | WASHINGTON, DC
From The Economist print edition

Relations with China have taken a bump. They may get even worse

AMERICA'S global reach means that the people who govern it, more than those in most other countries, are judged by how they handle foreign crises. The collision off China's coast between an American spy plane and a Chinese jet is the first such test for the Bush administration. So far, it has come through the challenge reasonably well, especially considering that China holds all the cards (that is, the aircraft and its crew). But if the handling has been cautious, the first results have also been modest, and the accident is fast turning into a defining moment in the two countries' souring relationship.

Reuters



Hardball in the spring

In the hours after the damaged surveillance aircraft touched down in Hainan on Sunday, the administration's reaction was reserved. As one senior official put it, America was trying to give the Chinese time to let things cool down.

The administration was careful not to talk of the arrested crew as hostages (a few congressmen were not so punctilious). More important, Mr Bush squelched any opportunity for the factions in his foreign-policy team to dash off in different directions by ensuring that the president himself and his secretary of state, Colin Powell, were the only ones to speak in public. The administration silenced senior voices on Capitol Hill who want to confront China more vigorously, such as Jesse Helms, the chairman of the Senate Foreign Relations Committee, and managed to speak with one voice.

By the third day of the stand-off, that voice was sounding exasperated. American diplomats had managed a brief contact with the arrested crew members, but little more than that. Worryingly, the administration had not then been able to speak with Chinese officials senior enough to get the matter resolved. Their own officials accused China of behaving in a way that was inconsistent with its professed aim of improving relations. Mr Powell admitted that "some damage" had been done to them. The president gave a public warning that China must return the aircraft and its crew, or risk undermining hopes for a "fruitful and productive relationship between our two countries".

That relationship seems to be getting no nearer as the days pass. Jiang Zemin, Mr Bush's counterpart, demanded that the Americans issue a full apology. He got a letter of regret about the missing Chinese pilot from Mr Powell. Mr Jiang's decision to leave China for a 12-day tour of Latin America the next day is likely to mean that yet more time could pass before the stand-off is resolved.

This could pose a problem of its own because of the underlying lesson—perhaps a salutary one—that members of the administration are drawing from the events. China, they think, is looking even harder to handle than anyone had feared.

In the first few weeks of the administration, Mr Bush's team had found the relationship with China less awkward than expected. True, the visit by Qian Qichen, China's chief foreign-policy man, had concentrated on the differences over missiles, Taiwan and human rights. But that was no surprise. In most other respects, the diplomatic contacts had been, well, diplomatic.

But the stand-off has disconcerted the Americans both because of its potential to spill over into bigger areas of dispute and, more immediately, because of what it says about the politics of China. After its first contacts, the administration had thought that China might use the spy plane as an opportunity to improve relations at little cost—at best by returning the plane and the 24 men and women it carried, at least by granting immediate access to them. Neither happened. China prevaricated, then played hardball.

The fear is that it may be testing Mr Bush much as Russia tested Jack Kennedy before and during the Cuba missile crisis of 1962.

This hardening scepticism makes several problems worse. The relationship of any established global power with a rising one is always likely to be tough. The list of problems for the two countries is long and complicated, ranging from weapons sales to Taiwan to trade policy with China and individual irritations (a Chinese defector here, an American arrested for spying there).

And America, like China, has its own hawks, eager to attack the other side. Their voices are likely to grow louder, especially in Congress. The House of Representatives not unreasonably voted to condemn China's human-rights record on Tuesday. Mr Helms has sent a bill to the Senate floor opposing China's bid for the 2008 Olympics. More important, Congress must vote on money for any new military equipment the administration proposes to sell to Taiwan, such as the Aegis anti-missile system. It must also vote on renewing the bill that opens the way for China's entry into the World Trade Organisation, unless China's entry is completed by June. On Wednesday, 28 congressmen proposed legislation to revoke China's trade benefits in the American market.

In short, those who want Mr Bush to be tougher with China have plenty of chances to push him that way. The toughest decisions over this awkward business have yet to come (what if China offers to give the crew back, but not the aircraft and its technological secrets?). As the stand-off continues, the hardliners on both sides will get stronger.

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Campaign-finance reform

Brave new world (perhaps)

Apr 5th 2001 | WASHINGTON, DC
From The Economist print edition

McCain-Feingold's expected—and unexpected—consequences

Get article background

AP

THIS week's vote in the Senate to overhaul America's campaign-finance laws was a rare example of a legislature acting like one. Senators listened to arguments and made up their minds in the chamber. Instead of ritual conflict along party tramlines, there was genuine uncertainty about how the vote would go. In the event, the McCain-Feingold bill passed by 59 votes to 41.

Even more remarkable is the uncertainty about what effect the decision will actually have. John McCain, the bill's co-sponsor, thinks it will purge politics of "special interests". Others voted for the bill because they thought it would damage the other party more than their own. The bill has yet to go to the House. It has yet to reach the president. And, of course, the Supreme Court could strike down part of the bill on the ground that it restricts free speech.

That said, the bill is a landmark, the biggest step so far towards reforming America's 27-year-old campaign rules. Assuming something like it becomes law, what practical effect might it have? To answer that, consider the three main actors on the campaign stage—the donors, the political parties and their candidates.

First, the donors. Will they react, as the reformers hope, by reducing the amount of money they give to campaigns? Senator Mitch McConnell, the self-described Darth Vader of campaign finance, says no. They are exercising first-amendment rights to influence politics. If they cannot spend their money one way, they will spend it another.

But there is some evidence that contributions do not come, as this suggests, solely from the supply side. They are partly "demand-led": that is, given in response to what is essentially a shake-down operation. Political bigwigs demand more and more money from established donors with the implicit threat that, if they do not get it, the company or interest group will be at the back of the queue when hearings are held on Capitol Hill. Charles Kolb of the Committee for Economic Development, a business group which supported McCain-Feingold, says that most corporate donations are given for fear of not giving. It is like an arms race. To the extent that this is true, McCain-Feingold would reduce the total sum given to campaigns by proving an argument against the shake-down. Unlimited contributions would be banned, and donations subject to a cap of $37,500 per person, per cycle.

Even if all the contributions were demand-led (and clearly not all of them are), huge sums would still flow into politics. So-called "hard money" (contributions from individuals to be used for any purpose) has risen from $280m in 1990 to around $700m now. It is likely to rise further as some soft-money donors switch to hard money instead. Moreover, donors who really want to finance political activity would be likely to react in ways that would make some donations even less transparent.

Parties are looking at ways to set up non-profit groups that could receive any amount of money. So one effect of the bill might be to create less accountable "quasi-parties". Donors could also engage in political activity directly, rather than through parties, as trade unions do now. Those with mass-memberships would concentrate on "retail politics" (getting out the vote, running telephone banks and so on). Donors without big memberships, such as companies, would concentrate on the most expensive part of a campaign, buying television time; nearly all the growth in "soft money" has gone on this. The McCain-Feingold bill would ban so-called "phoney issue ads" (thinly-veiled campaign advertisements financed by outside groups) within 60 days of a general election. This is the part of the bill that looks most vulnerable to Supreme Court scrutiny. If it were struck down, donors' advertising spending would be unlimited. If it

were sustained, the ads could still be bought—but early in the campaign, as they used to be. Either way, “special interests” would continue to play a role.

Parties would at first be weakened, compared with outside groups, because so much of their activity depends on soft money. But they would not be destroyed. They would have to adjust by expanding their base away from large corporate and union donors to individual contributors, which is what they used to do until the early 1990s. This would be harder for Democrats than Republicans, who have an advantage among donors willing to spend $1,000-$2,000 on a candidate. Such an expansion would take time and money because it requires a costly investment in direct-mail operations. But the effort would strengthen parties’ grass-roots organisation. Beyond that, parties would also retain a role in organising opinion-poll research, political consultancy and candidate recruitment: all areas where they can profit from economies of scale.

Lastly, McCain-Feingold would increase competition between candidates by slightly tilting the balance away from incumbents and towards challengers. Challengers get slightly more of their hard money from donors who give the maximum amount. The bill would double that amount, so in principle it should be easier for challengers to reach the threshold of getting established.

Since parties tend to compete with their own candidates for hard money (and lose, since the parties cannot do the donors direct favours), the increase in hard-money donations could help candidates at the parties’ expense. But that could increase electoral competition because, in the 2000 election, the national parties in effect abandoned 95% of the races to incumbents, and concentrated all their money and attention on 20 or 30 super-expensive contests.

On balance, the bill, if it became law, could do more good than harm. But it is not a cure-all. It is not even entirely a new start. In some ways, McCain-Feingold would return the dollar-politics relationship to something like what it was in the 1980s. And after that the political system would presumably alter, as it did then, in nefarious ways requiring another crusade in 20 years’ time.

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The economy

Consumers to the rescue?

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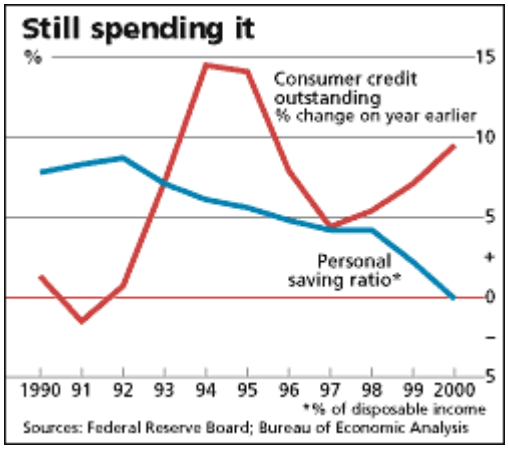
AS WITH most paths from mountain-top to valley, the road into recession tends to be winding and uneven, with enough flat or even rising stretches to raise the occasional hope that the traveller has reached the bottom. The past few weeks' data have been sufficiently ambiguous to convince some economists that the descent of America's economy is nearing an end, though many others fear further steep drops. Who is right may depend largely on whether consumers, who have so far carried on spending fairly freely, decide to shut their wallets.

The manufacturing sector has been a source of modest encouragement for the optimists. True, it remains in recession. But the National Association of Purchasing Managers' manufacturing index unexpectedly edged up a bit in March, suggesting that the rate of decline in activity is slowing. The big car makers, whose sudden troubles a year ago made them the leaders of the economic retreat, reported a fall in sales in the first quarter. Even so, they claimed, sales were better than expected, things look better for the second quarter and the surge in inventories that had caused so much alarm is being brought under control.



The NAPM non-manufacturing survey was also less worrying than some economists had feared. The index fell in March, but not by much. This is a much newer indicator than the NAPM manufacturing survey, so nobody really knows how to interpret it. But plenty of economists are happy to regard a merely small fall, in today's gloomy climate, as a reason for optimism.

Some economists also take comfort from the Federal Reserve, which shows every indication that it is ready to cut interest rates as low as is necessary to get the economy back on its feet. Even after the 150 basis points of cuts so far this year, monetary policy is now merely neutral rather than tight. The markets are forecasting that it will become stimulative shortly, with interest rates falling to 4.5% or lower (from 5% now) over the next two Fed meetings, on May 15th and June 26th-27th, and maybe even sooner.

That is the rosier view of the Fed's actions. A gloomier one is that the central bank is unimpressed by the not-so-bad-after-all numbers mentioned above, and knows that it has its work cut out avoiding a recession, perhaps a severe one.

The interest-rate cuts so far this year have not calmed the nerves of corporate America, where the outlook for profits is deteriorating daily, and any spending that can be postponed has been—with technology spending, in particular, screeching to a halt. Many firms have been delaying more drastic action, such as big job cuts, in the hope that the economy will rebound quickly; but each day it does not, more will have to act. The impact of rate cuts has been limited, not least by the banks: so much so that Alan Greenspan, the Fed chairman, has warned them, again, not to deny loans to fundamentally sound credits.

The one unworried head in this storm, at least until now, has been the American consumer, who still shops as if there was no tomorrow. Consumer spending, which accounts for two-thirds of GDP, continues to rise, and is on course for real year-on-year growth in the first quarter of over 3%. Americans are still straining their credit cards, after a brief flirtation with prudence in December. Their spending exceeds after-tax income—the "negative savings rate"—by a record amount. Incredibly, this has happened despite a sharp fall in consumer confidence; it plunged to a four-year low in February, before improving somewhat in March.

So what happened to the much-cited "negative wealth effect" supposedly caused by the past year's

plunge in share prices, particularly the Nasdaq? The destruction of several trillion dollars of stockmarket wealth seems to have influenced only what Americans say, not what they do. There is a strong correlation between changes in the Nasdaq and the level of consumer confidence, but not between the Nasdaq and spending.

People may be much slower to allow changes in share prices to influence their spending than has been supposed up to now, says Henry Willmore, an economist at Barclays Capital. In the past, they have been twice as likely to consume out of gains in the value of their homes as out of share appreciation. Strikingly, last year, the value of owner-occupied property went up by over 10%, the biggest increase since 1985. This raised household wealth by around $1.1 trillion, roughly half the loss due to falling share prices—but enough, on past trends, to cancel out the negative wealth effect of the stockmarket.

Will tumbling share prices now trigger falls in house prices? There is some evidence of this at the luxury end of the market. But in the past, there has been no strong correlation between share prices and house prices. If anything, they tend to move in opposite directions.

Supporting the housing market seems to have become the focus of the Fed's activities. Its rate cuts have stimulated a boom in mortgage refinancings, which gives money straight to consumers. Most of the recent rapid increase in the money supply stems from the lending activities of two federally sponsored mortgage agencies, Fannie Mae and Freddie Mac, which as a result are facing growing political scrutiny.

If the housing market continues to boom, it should lead to an acceleration of consumption, led by increased spending on "big ticket" items, from ovens to carpets, as the year goes on, according to Carolyn Scott of McCoy Scott, a consultancy.

The main risk to this rosy scenario is the labour market, which has so far remained more resilient than economists thought likely. However, unemployment tends to follow economic activity with a lag. And in this downturn companies have been particularly reluctant to fire workers, since hiring has been hard in recent years and the economy may recover quickly. If they do start to wield the axe with zeal, consumers will have to learn restraint.

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Lexington

The Golden State turns brown

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From The Economist print edition

POPULATIONS are fluid, but demography is rigid. The census, which freezes the flow of humanity into categories, creates sharp points and discontinuities in what is really a steady process of change. California is marking, for the most part with pride, one such artificial landmark produced by the 2000 census. Somewhere in the past ten years, the number of Californians who describe themselves as white fell behind the number who describe themselves as something else.

To put it in shorthand, “whites are no longer a majority.” It is true that the 47% of Californians who are listed as white in the census include some Middle Easterners with dark skins and exclude those, among the 32% counted as Hispanic, who might also consider themselves white. But arguments over where the milestone is placed do not alter the road.

The change has happened fast; as recently as 1950, Hispanics were only about 6% of the population. Whites made up around 90%. The drop since then is steep and is accelerating. At present, more than half of the state’s adults are white, but the word covers only a third of its residents who are less than 18 years old; and in the numbers of births and immigrants whites fall a long way behind non-whites.

In taking this path, California is showing the rest of America its future—one in which whites and blacks will share the country with a larger proportion of the population that has Asian or Latin American origins. As it passes its milestone, California offers reasons for both gloom and hope about this future.

Pessimists can point to a series of referendums called by voters in the 1990s that seemed to express white resentment. One barred illegal immigrants and their children from receiving all but emergency government services; another ended affirmative action, selection by race rather than merit; a third banned bilingual education in schools. All passed by large margins. If the economy goes into recession, this could increase the anger against immigrants, who can be accused of taking jobs away from people who have lived in America all their lives.

There are more reasons, however, to be optimistic about California’s experience as the country’s most ethnically diverse large state. Of those referendums, only the first, Proposition 187 banning services for illegal immigrants, was truly racially divisive. Pushed by politicians eager to exploit anger about the long recession from which California was just emerging, it won a majority, and helped to propel its proponents to success. But its longer-run impact has been quite different. Latinos, who are now voting in increasingly large numbers, turned against the state’s Republican Party, which had embraced 187. The party has still not recovered.

Ending affirmative action and bilingual education, on the other hand, had wide support among Latinos from the start. They rightly saw these referendums as attempts to dismantle obstacles to assimilation into America. Support for the affirmative-action measure divided along ethnic lines only when politicians versed in the race-based politics of multiculturalism decided to link it to Proposition 187. The anti-bilingualism initiative kept high levels of Latino support right up to voting day, and has become even more popular since then as children of Spanish-speaking parents have started to do better at school.

Multiculturalism grew out of the politics of the black civil-rights movement. But, in practice, California follows an older American pattern. The melting pot works even more efficiently today than it did when the idea of apparently different peoples blending together as Americans first became a cause of celebration. Up to 40% of the American-born children of Asians and Latinos, the fastest-growing groups in California, marry outside their own ethnic groups, a far higher proportion than the 5-10% typical of second-generation Italian-Americans and Jews in the middle of the 20th century.

For Latinos, themselves the product of racially mixed Mexico and other Latin American countries, the idea of the melting pot is much more attractive than defensive multiculturalism. California, leading the way statistically, can pass on to the rest of the country what it is learning from its newest citizens: in

America, ethnic boundaries can dissolve.

What seems new as California becomes more Hispanic is also a rediscovery of the past. Before it joined the union in 1850, California was part of Mexico. Until the gold rush, most Californians were Spanish-speaking ranchers and missionaries, or native Indians. Kevin Starr, a historian, has suggested that the 20th-century white majority may come to be seen as an historical aberration.

In truth, the state is at root neither Hispanic nor white. Early California was not so much Mexican as empty; the non-native population in 1840 was less than 10,000. And unlike New Mexico's Hispanics, many of whom can trace their roots to the first Mexican settlers, most Californian Latinos are the product of immigration within the past 30 years. Immigrants come to California looking forward, not back.

There is in any case something perverse in arguing whether such immigrants will change the nature of America. While the anti-immigrant lobby frets that America is in danger, the rest of the world embraces, or denounces, what it calls Americanisation. "American culture" reaches children in tiny villages in the Andes. The thought that the children of Peruvian immigrants growing up ten miles from Hollywood could undermine it is laughable.

As they have always done, immigrants to America will become American even as they mildly change the American mixture. The fact that California's immigrants tend to be Hispanic and Asian will continue to shape the character of the state, but it will not alter its Americanness. America is full of regions and states that are no less American for being numerically dominated by particular groups: Utah, with its Mormons; Hawaii, Asian from the start; Wisconsin, where 45% of the population is of German descent.

What all Californians, Hispanic, Asian and otherwise, want is housing, schooling, jobs and health care. The real challenge in California's census result is not in the fine print but in the simplest number of all, the grand total: 33.9m people, and growing fast.

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The renaissance of Gianni Versace

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IN THE summer of 1997, a fortnight before he was shot dead on the steps of Casa Casuarina, his Miami home, Gianni Versace was given the keys of Florence in honour of his contribution to Italian culture. Stepping up to accept the award, he cried, with outstretched arms, "I feel like a Medici." The auction in New York this week of the paintings and furnishings that adorned Casa Casuarina reveals a person obsessed with presenting himself as a latter-day Renaissance Man. Was he?

Reuters

Just right for the front yard

It might seem a hard case to make. To most people, Versace was associated more with vulgarity than high art. The gaudy, jewel-encrusted clothes he designed were derided as *il stile puttana*, whores' style. His murderer was a homosexual whom, in all likelihood, Versace had once picked up on South Beach, a prowling-ground for many of the bronzed hunks he is said to have entertained at Casa Casuarina. This $19m, 20,000-square-foot, 12-bedroomed pleasure-dome, with its Roman marble baths and Egyptian and Pompeian suites, seems an unpromising domain for a serious patron of the arts.

Yet an inspection of the 600 or so items up for sale in the three-day auction starting at Sotheby's on April 5th makes one think again. Certainly the collection, expected to fetch upwards of $7m, is unapologetically gaudy, and displays a wild mix of styles. Neo-classical Greek busts sit alongside figurines of lions and sphinxes and a rather daunting collection of gilded phallic columns and candlesticks. But there is also a fine collection of micro-mosaics and Indian miniatures, a large group of 19th-century European paintings and some 80 pieces of French Empire-style furniture, all of which Versace apparently bought in a single day. Benjamin Doller, a Sotheby's specialist in 19th-century paintings, says Versace "had an art-historian's eye."

The collection reveals something many Americans hold dear—reinvention. A working-class boy who grew up while his mother sewed in her modest shop in a seedy, Mafia-run town in southern Italy, Versace spent his life putting his origins behind him. His closest friends were the people whose pictures appeared in the world's glamour magazines. He dressed Princess Diana and Elton John. In 1977, a six-page spread in the Italian edition of *Vogue* showed a moody photograph of Versace and his family, dressed in elaborate costumes, holding menacing black dogs and posing like aristocrats on the steps of an ornate villa. What the readers were not told was that the clothes, the dogs and the house itself were all borrowed props. As a close friend said of him: "For Gianni, it was not important what you are, but what you appear to be."

Versace's taste for reinvention went beyond his own life. He took other people's works of art and put them on things like boxer shorts, earning himself the nickname of "Versace Copyaci". Some of the most interesting pieces coming up for auction this week are chairs and sofas he re-covered in his own colourful fabrics. This irreverent mixture of classic and modern exerts a powerful attraction. Jennifer Aniston, star of "Friends", is said to have her eye on Versace's $90,000 Indian rosewood settee.

In the end, Versace may be more Andy Warhol than Lorenzo de Medici. That will not diminish his appeal to the new aesthetes.

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Detroit

Archer's target

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AP

Good job, Mr Mayor

SOME time this month the mayor of Detroit, Dennis Archer, will decide whether or not to seek a third four-year term. The Archer years have been good for Detroit, or at least much better than the two decades that came before. The city has a new downtown baseball stadium; a new football stadium will be finished next year. Three new casinos are generating $80m a year in revenues for the city. Compuware, a software company, is moving its headquarters and 6,500 workers into the city. The Detroit Comeback Index, which measures the health of the city by 23 indicators ranging from business start-ups to school performance, has climbed from 100 in 1994 to 119.5 (having peaked at 122.8 last year), according to its creator, Comerica Bank's chief economist, David Littmann.

Mr Archer, one of *Governing* magazine's Public Officials of the Year for 2000, says he is "leaning towards" running again. But why should he (or any other big-city mayor) want the job? Mayors face all the bare-knuckle battles of national or state politics with fewer resources and more constraints. Mr Archer, fit and trim at 59, picks at an annoyingly healthy lunch of fruits and vegetables in his City Hall office as he reflects, "I've grown accustomed to stress. I understand now how much I can mentally and physically absorb because we've had some challenging issues in our city—some that I didn't anticipate when I ran for office."

Detroit's problems are even bigger than those of most other American cities. The suburbs beckon. The 2000 census figures released at the end of March show that Detroit's population has fallen below 1m for the first time since the dawn of the automobile age. Some of America's other big cities, such as New York and Chicago, have populations that are at last on the rise. Mr Archer points to $13 billion in new investment during his tenure. Still, Detroit, a city that stretches over 180 square miles, gets its first commercial cinema when he cuts the ribbon on a ten-screen monster on April 6th.

The schools are a shambles. In 1999, Mr Archer took a bold step to try to make them better. He convinced the state legislature to dismantle the elected school board and replace it with a board in which the mayor appoints six of the seven members. "It was an enormous, tension-filled, racially-filled, high-action, high-emotional drama," says the mayor. Yet the school system still makes many parents flinch. Michigan law allows students in Detroit to attend either the rather superior charter schools or public schools outside Detroit that will accept them. Since 1997, 19,000 students have fled from Detroit's public schools, taking $80m-worth of financing with them.

Businessmen are clamouring for more dependable government services and faster relief from Detroit's tax burden. Mr Archer has cut the city's corporate tax from 2% to 1.9%; its income tax on residents will be cut over 10 years from 3% to 2%, and the income tax on workers who live elsewhere but work in Detroit will be cut over the same period from 1.5% to 1%. Mr Littmann describes these as "grudging, minuscule, but in-the-right-direction tax decreases". The city still generates its own power for street lighting, a service so notoriously unreliable that Mr Archer claimed as an accomplishment in his 2001 state-of-the-city speech the fact that 95% of the city's street lights are now working. Many believe the system should have been privatised long ago.

Two Democrats and an independent have declared themselves as rival candidates for the mayor's job. They all bash Mr Archer for bad schools, poor police and fire services, dim public lighting, messy parks and letting abandoned buildings fall to bits.

The city council gives little to Mr Archer without a fight. Small issues illustrate the tension of the mayor's days. Consider a modest proposal to clean up Belle Isle, a big and popular but rundown park where Mr

Archer runs three miles every day. He proposed a $3 fee for every car driving on to the island to cover the cost of maintaining the park and improving its facilities. (City workers report that they have picked up 6,000 tons of trash on the island since 1998.) The park would still be free for residents who arrived on foot, bicycle or city bus. The council rejected Mr Archer's proposal not once but twice. It may yet end up as a referendum on the ballot. "After much effort, he wins battles, but the frustration is that those battles have to be fought," says Paul Hillegonds, president of Detroit Renaissance, a coalition of Detroit business leaders.

Mr Archer's approval rating lingers around 60%, down from his 1997 re-election tally of 83%. The business community is less effusive in its praise of him than it was a few years ago. Still, businessmen will rally when called upon. They have not forgotten Mr Archer's predecessor, Coleman Young, whose administration declared war on business and the suburbs, heightened racial tensions for political gain and botched the finances so badly that the city's bonds fell to junk grade. The bond-rating agencies have upgraded Detroit's credit 11 times during Mr Archer's tenure. Comerica's Mr Littmann, who can produce a long list of things the city needs to do faster, cheaper or better, still calls Mr Archer a "force of enlightenment".

What might persuade him to run again? The cynics can point out that the perks are nice: a house on the river, a car and driver, trade missions to Europe and Asia, where American big-city mayors are still greeted with respect. The more convincing answer is that mayors matter in Detroit, as in America's other big cities. Whereas American presidents can change the nation by degrees, and state governors are remembered for a programme or two, effective mayors can really turn cities round.

Bruce Katz, director of the Centre on Urban and Metropolitan Policy at the Brookings Institution, places Mr Archer in a class of mayors who have made profound physical and social changes in their cities: Richard Daley (Chicago), Thomas Menino (Boston), Rudy Giuliani (New York), Wellington Webb (Denver) and Henry Cisneros (formerly of San Antonio). Their achievements compare with the decades in which urban politics consisted of sharing the spoils while papering over a city's decline. The great mayors, thinks Mr Katz, say: "This is going to change."

Mr Archer has plenty left to do, should he so choose. It would be understandable if he took his due credit for eight years of hard work and decided to spend the next four playing golf. It would be a shame, though.

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The budget

Not yet time for the champagne

Apr 5th 2001 | WASHINGTON, DC
From The Economist print edition

AS IF he did not have enough to worry about this week, George Bush has discovered that his tax plan faces big trouble in the Senate. On Tuesday, it survived a Democratic amendment only because Vice-President Dick Cheney used his casting vote. On Wednesday, however, the Senate voted to redirect $450 billion of the proposed cuts, abut a quarter of the total, to education and repayment of the national debt.

Support for the plan is more solid in the House than in the Senate which, split 50-50 as it is, is a delicate place to do business. But there are at least three reasons for thinking that Mr Bush faces serious problems in the months ahead. The most important is that the rationale for cutting taxes is hopelessly confused. In his bid last year to win the Republican presidential nomination, Mr Bush needed both to escape from the shadow of his tax-raising father and to head off a challenge from tax-slashing Steve Forbes. So he produced an ambitious plan to cut taxes by $1.6 trillion. He also wanted to show that he was fiscally responsible. So he produced a plan that would phase in his cuts over ten years, with 80% of the cuts coming after 2006.

But since then, with a slowing economy, Mr Bush has invented a new justification for his plan—as a weapon in the fight against a potential recession. To justify this he needs, at the very least, to re-shape his package to speed up its impact. Many Democrats say he needs to re-shape it even more, to put money in the pockets of middle-class consumers rather than the wealthiest 1% of Americans.

The plan also rests on optimistic assumptions about the size of the surplus. It was conceived during a roaring economy when money was pouring into government coffers. Now a slowing economy casts doubt on projections that there will be $5.6 trillion in surplus revenues over the next decade. This has led some legislators, including both Democrats and Republicans, to support a “trigger mechanism”, a budget target that will have to be met before tax cuts take effect.

The third head-scratcher is just where public opinion stands. It is true that most voters want lower taxes. But the majority is getting slimmer: a Zogby poll shows that the number of people who support Mr Bush’s scheme has shrunk from 56% of the population three months ago to 51% today.

The past few days provide a brief glimpse of things to come. On Tuesday, it took both Mr Cheney’s casting vote, and Republican agreement to increase spending on prescription drugs above Mr Bush’s limits, to defeat a Democratic proposal to shift money from tax cuts to prescription-drug coverage. On Wednesday three Republicans defected to vote for the Democratic plan. The Republican leadership has kept its waverers in line only by agreeing to increase spending on their pet programmes. Even so, Jim Jeffords, a Vermont Republican, who broke ranks on Wednesday, sounds determined to withdraw his support from the whole plan. He favours an alternative tax proposal devised by John Breaux, a Democrat from Louisiana.

So was Mr Bush foolish to invest so much of his political capital in cutting taxes? Not necessarily. There is little doubt that some form of tax cut will eventually be passed. This is partly because the Democrats do not want to be seen as the party of high taxation, but also because there is a widespread feeling that the slowing economy has made tax cuts more necessary than ever. Mr Bush has a long record in Texas of allowing the legislature to rewrite his tax proposals and then claiming credit for them anyway. Expect him to repeat this trick when the budget finally emerges from the legislative maze.

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A murky democratic dawn in post-Fujimori Peru

Apr 5th 2001 | LIMA
From The Economist print edition

This weekend's election should at least be free and fair, but a dirty campaign has left Peruvians disillusioned with politicians

AP

Toledo appeals to the mountain gods

ALEJANDRO TOLEDO sounded hoarse this week as he spoke at campaign rallies. It is the second time in a year that Mr Toledo, an economist of the centre-left, has run for president. Last year, he was the chief challenger to Alberto Fujimori in a rigged contest. Now, as Peruvians prepare to vote again on April 8th after the sudden collapse of Mr Fujimori's regime, Mr Toledo leads in the opinion polls. But he cannot yet be certain of victory. With no candidate likely to win an outright majority in the first round, the election seems headed for a run-off.

That uncertainty is itself a sign that democracy, or at least its outward apparatus, is swiftly returning to Peru after a decade of increasingly corrupt and authoritarian rule by Mr Fujimori and Vladimiro Montesinos, his sinister intelligence chief. With both men now out of the country, Peru is ruled by an interim government of competent technocrats. The army command has been cleared of Mr Montesinos's closest cronies. The media are operating freely and the electoral authorities have been changed. There should be no repeat of the chicanery of last year's election, when media coverage and the vote count were manipulated by the intelligence service.

But the campaign has been a dirty affair, marked by racial and other slurs, and has done little to restore public faith in politics. Ironically, Mr Toledo, after his dogged campaign against the corruption of Mr Fujimori's regime, is himself the subject of allegations of a different sort of sleaze. He is opposing a claim by a 13-year-old girl that he is her father and has refused to take a DNA test, unless ordered to by a court (after the election). Last month, *Caretas*, an independent news-weekly, published a medical certificate that showed Mr Toledo tested positive for cocaine in October 1998.

The candidate says the drug test came after he had been kidnapped by intelligence agents and doped (the test also showed a sleep-inducing drug); his wife had raised the alarm that day. But rivals insist there are unanswered questions. According to a police report at the time, Mr Toledo made no mention of any abduction. He is alleged to have spent the day in a Lima hotel, where he signed for hefty credit-card purchases made by three unidentified women.

Mr Toledo attributes the allegations, which were first made last year, to dirty tricks by remnants of the old regime. He has compared himself to a *piñata*—a papier-mâché dummy that children bash open at birthday parties—because everyone has been swiping at him. Of Andean Indian descent, Mr Toledo worked as a shoeshine boy as a child before winning a scholarship to Stanford University in California, where he met and married Eliane Karp, a Belgian anthropologist. Many poorer Peruvians identify with his success, but Peru's elite distrusts him—although he is now part of it.

The scandal has not helped Mr Toledo, but it has not done huge damage. According to Apoyo, a polling company, his support is fairly steady at 35%. His closest challenger has been Lourdes Flores, an effective if rather prim Christian democrat. But her campaign has faltered recently. Perhaps her father should not have called Mr Toledo a "cameloid". Ms Karp replied that, after 500 years of white rule, it was time for power to return to the Indians. "The *Apus* [mountain gods] have spoken," she said. That did nothing, however, for Mr Toledo's increasingly strained relations with businessmen.

Garcia helps himself

The main beneficiary of the mud-slinging has been Alan Garcia, a populist former president. After eight years abroad, he is now challenging Ms Flores for a place in any run-off. Many Peruvians associate his

presidency with hyperinflation, terrorism and corruption, but he is a charismatic and ruthless politician, and his campaign has exploited voters' economic worries. Still only 51, he is now in a strong position to return to power, if not this time, in 2006.

Whoever gets through to the second round, Mr Toledo is still its likely winner. Peruvians are inured to scandal: for months, television has shown excerpts from some 4,000 videos secretly recorded by Mr Montesinos as part of his huge racket of bribery and political manipulation. The first job for the next president will be to make alliances. No candidate will win a majority in Congress; Mr Toledo's supporters are unlikely to take more than a third of the seats. Mr Garcia's APRA is the strongest party, but is a shadow of its former self. The other candidates head loose amalgams, lacking both ideology and discipline.

The second job will be to rebuild Peru's institutions, after a decade in which Mr Fujimori and Mr Montesinos centralised power in their own hands.

The third task will be to expand an economy that is shrinking as investors recoil from political uncertainty. Both Mr Toledo and Ms Flores claim to be committed to fiscal prudence and a market economy, but want to boost jobs with a crash programme of low-cost housing. Mr Garcia strikes a more populist note, attacking privatised utilities and calling for lower interest rates.

Whoever wins, the hardest task may be to restore public faith in democratic politics. Gone is the unity that marked the fight against Mr Fujimori. The voters seem unenthusiastic about all the candidates. With only a week to go, a fifth remained undecided. That is partly because they have been bombarded by unrealistic promises. It is partly, too, because Peruvians have become accustomed to disappointment from their leaders. "Peru is like a spouse who has been cheated on: there is a lot of hurt and mistrust. The next president has to be able to make us believe in something again," admits Hugo Otero, an adviser to Mr Garcia.

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Foot-and-mouth in South America

Apr 5th 2001 | SAO PAULO
From The Economist print edition

Like Europe, South America is trying to contain a pernicious cattle disease without hurting exports

Get article background

Reuters

Give them a jab?

SOUTH AMERICA produces some of the world's cheapest and best-tasting beef. But its ranchers are watching Europe's cattle diseases with mixed feelings: optimism that a collapse in European meat production will boost their exports—and horror at the thought that they might face the same problems. They had some good news this week: the European Union declared Brazil, like Argentina, Uruguay and Paraguay, its partners in the Mercosur trade block, to be at very low risk from mad-cow disease. But there was bad news too: in Argentina, an outbreak of foot-and-mouth disease (FMD) has grown worse, with cases at 175 ranches. And there were rumours of a new outbreak of the disease in southern Brazil.

Both Brazil, with sales worth $779m last year, and Argentina, with sales of $603m, are big beef exporters. Though their exports are worth less, Paraguay and Uruguay depend more heavily on beef than their bigger neighbours. For all four countries, hopes of increasing their sales in big markets such as Western Europe and North America depend on eliminating FMD. So its resurgence, just when the region seemed close to wiping it out, is a dispiriting blow.

Brought to South America by livestock from Europe a century ago, foot-and-mouth has been in retreat in the region since the 1980s, thanks to vaccination. There had been no cases in Rio Grande do Sul, Brazil's southernmost state, after 1993 until an outbreak last August—its cause is still unknown—which led to 11,000 animals being slaughtered. Despite this cull, Emilio Gimeno, the regional official of the Office International des Epizooties (OIE) in Paris, the agency that monitors animal infections worldwide, says that the disease seems to have crossed into Uruguay, causing an outbreak in October in which 21,000 animals had to be killed.

Mr Gimeno says that Argentina's outbreak also seems to have begun in August, when cattle carrying the FMD virus were imported illegally from Paraguay—which, nevertheless, still claims to be free of the disease. Argentina killed 5,000 animals, and at first claimed that it had successfully stamped out the outbreak. Its government now says that it has no money to spend on a wider cull. Instead, it is trying to contain the disease, which is afflicting five provinces, by vaccinating livestock in a ring around each affected ranch.

Unlike Britain, which has a policy of slaughter, the Mercosur countries seem likely to stick with their policy of trying to control outbreaks of FMD through vaccination. That may be the only feasible way, but it carries a cost for their exports. Many importers, such as the United States, buy chilled sides of beef only from countries that are not just free of FMD but maintain this status without vaccination. Otherwise, the meat must usually be boned, frozen or cooked.

In the hope of increasing their sales of chilled beef, Argentina, Paraguay and part of southern Brazil had recently stopped vaccinating, as Uruguay had done earlier. The fresh outbreak shows that this was a mistake, says Cesario Ramalho, who runs a 35,000-head ranch near Brazil's border with Paraguay. He blames the OIE for pushing for vaccination programmes to be abandoned prematurely.

The OIE's Mr Gimeno concedes that it may have to reconsider its policy. Argentina, he says, should perhaps return to mass vaccination for a few years. Paraguay, he believes, has already begun doing so. Farmers and the state government in Rio Grande do Sul also want to resume vaccination. The federal government and the neighbouring state of Santa Catarina are against that. But if the rumours of renewed outbreaks in southern Brazil prove correct, a resumption of immunisation will probably follow.

Eliminating FMD without vaccination would quicken the prospects for South America's beef exports. But in the United States they would still be held back by import quotas and heavy subsidies to domestic producers. And in Europe, the sight of burning carcasses seems to be putting many consumers off red meat altogether. For South America's ranchers, the opportunities are big, but as elusive as ever.

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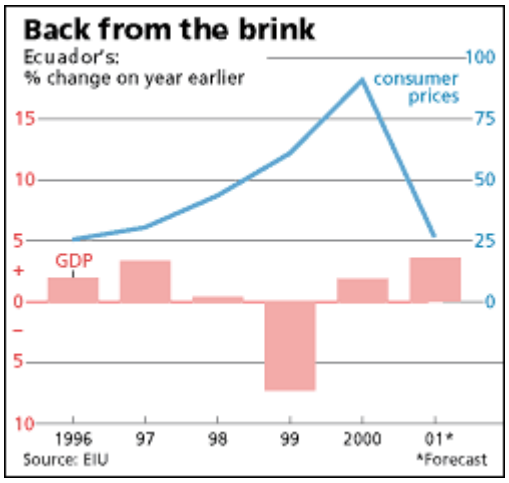
Ecuador

Taxing

Apr 5th 2001 | QUITO
From The Economist print edition

Get article background

WHEN Ecuador dumped its debased currency in favour of the dollar last April, nobody expected the road ahead to be easy. Yet the economy, buoyed by high oil prices, has done better than expected: GDP grew by 2.3% in 2000, unemployment fell and the public finances were in balance. All of that was achieved without many of the painful reforms that the IMF believes are needed to make dollarisation work in the medium term.



But now oil prices are falling, and the country can no longer avoid some tough decisions. On March 29th, Congress voted by a large majority to reject the government's proposal for a three-point increase in VAT, to 15%; the legislators also voted for a cut in the top rate of income tax (from 25% to 15% on incomes above $30,000), and threw out other revenue-raising measures. The increases are needed to help balance this year's budget. Without them, the fiscal deficit will rise to 3.9% of GDP this year, according to Jorge Gallardo, the finance minister. The government needs the money partly to pay debt.

The government's defeat has thrown doubt on Ecuador's agreement with the IMF, worth $1.7 billion in loans. To satisfy the IMF, President Gustavo Noboa could try to use his veto powers to push the tax increase through (and hope that opponents lack the two-thirds majority needed to override his veto). Another option might be a compromise, involving a smaller increase in VAT. Mr Noboa may wish to avoid a confrontation with Congress, since he needs its approval for social-security and pension reforms.

The outlook is not wholly bleak for Ecuador. In February, Mr Noboa signed a contract to build a much-delayed oil pipeline, costing $1.1 billion. This investment alone should boost GDP by at least 1% annually for the next two years and indirectly create up to 50,000 jobs. Once the pipeline comes on tap in 2003, it should increase Ecuador's oil exports by at least 50%, boosting government revenue. The government now plans to go ahead in July with the privatisation, also much delayed, of 19 electricity-distribution companies, followed by the sale of generation and transmission companies.

But with an election due in 2002, Congress and the president are likely to find themselves at odds over unpopular economic measures for the remainder of Mr Noboa's term. And the president could end up on the losing side.

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Colombia

Haven sent

Apr 5th 2001 | BOGOTA
From The Economist print edition

Reuters

Gomez tries not to look quixotic

SINCE February 1999, the smaller of Colombia's two guerrilla groups, the National Liberation Army (ELN), has been asking the government of President Andres Pastrana to set up a "demilitarised zone" in the north of the country as a haven where peace talks could take place. Now, after many false starts, it looks as if the government may soon be able to oblige. Last weekend, the last of some 3,000 army troops withdrew from the area after a seven-week operation.

In meetings held mainly in Cuba, negotiators from the government and the ELN have agreed on many of the details of the proposed zone. It will be subject to much tighter conditions than a similar enclave Mr Pastrana granted to the FARC, Colombia's largest guerrilla army, over two years ago. At 4,000 square kilometres (1,550 square miles), the ELN zone is less than a tenth the size of that held, and in practice run, by the FARC. And unlike the FARC, the ELN has had to accept that its zone will be monitored by a team of observers, some of them foreign.

There have been other obstacles. The site proposed for the enclave was once an ELN stronghold, but the guerrillas were driven out of much of the area by the right-wing paramilitaries of the United Self-Defence Forces of Colombia (AUC). The AUC's leader, Carlos Castaño, has whipped up opposition to the zone among local residents. In February locals blocked roads in protest against the zone, paralysing much of northern Colombia. Many of the protesters had been intimidated into taking part.

The government's response was an army sweep, called Operation Bolivar, in the department of that name. Its ostensible aim was to reassure civilians by driving out guerrillas and paramilitaries, and to destroy the coca plantations that provide both sides with income. Some 5,600 hectares (13,000 acres) of coca were sprayed with weedkiller by the police; so too were a third of the food crops on the affected farms, according to a local farmers' association. But only 12 rebels were killed and 28 captured.

The operation raised several questions. The army's critics say that the fact that it took the AUC's headquarters in the region without resistance and without prisoners points to collusion between officers and paramilitaries. Last month, the ELN broke off its contacts with the government, saying that it was the army's real target. When Mr Pastrana ordered an end to the operation, the general in charge claimed that he was just 24 hours away from taking the ELN's command post.

Nevertheless, the operation may have achieved something. Local leaders, who have also been promised development aid, have given signs of distancing themselves from the AUC and falling in behind the government's plans. The ELN is talking to the government again: on April 1st, Camilo Gomez, the government's peace commissioner, met guerrillas in the enclave. Later this month, an international committee is due to make proposals for setting up a monitoring mission.

So if the ELN does get its haven, what will that mean? With some 3,500 troops, the ELN is much weaker than the FARC, and seems keener than its larger rival to make peace. Colombians will hope that the guerrillas will stop their campaign of kidnapping and sabotage. The ELN is especially fond of blowing up Colombia's main oil pipeline, which causes environmental as well as economic damage, and its electricity pylons.

But progress is unlikely to be swift. The ELN wants to hold a “national convention” with “civil society”, lasting several months. Unless it also declares an end to hostilities, that will put Mr Pastrana under more pressure. Already he is criticised for having made too many unilateral concessions to the FARC. Even so, talks with the ELN may represent the best chance of a tangible success for Mr Pastrana’s peace policy before he leaves office in 17 months’ time.

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A hint of the cold war over the South China Sea

Apr 5th 2001 | BEIJING
From The Economist print edition

China and the United States are at loggerheads after a flight by an American spy plane that went wrong

Reuters

Wounded eagle

IN THE months since President George Bush took office, some policy analysts in the United States have expressed fears that his unvarnished approach to foreign affairs would be badly received in China and risked steering the two countries on to a possible collision course. Those fears seemed to come horribly true in the skies over the South China Sea on the morning of April 1st—All Fools' day in some countries—when a sophisticated American military surveillance aircraft collided with a Chinese fighter jet.

The Chinese plane went into the sea and hopes of rescuing its pilot, Wang Wei, now seem slim. The damaged American plane made an emergency landing on the southern Chinese island of Hainan, where it and its crew of 24 have been held by China's military authorities, and have become the object of a tense, high-stakes stand-off. Sharp words have been exchanged, with officials in Beijing and Washington giving divergent accounts of the collision, and differing legal interpretations over who is to blame and what ought to happen next. As it stretched into its fifth day, the drama was stirring passions among Chinese nationalists and American hawks alike. However it turns out, the episode has further strained already difficult relations between the two governments. Unless a quick solution is found, it may cause worse trouble yet.

According to China's account of the incident, the Chinese navy sent a pair of F-8 fighters to follow and monitor the American EP-3 reconnaissance plane as it flew some 105km (65 miles) south of Chinese territorial waters along the Hainan coast. The EP-3, China said, "suddenly veered" and rammed one of the Chinese fighters, sending it crashing. Without requesting permission, the American plane landed 26 minutes later at Hainan's Lingshui military airfield.

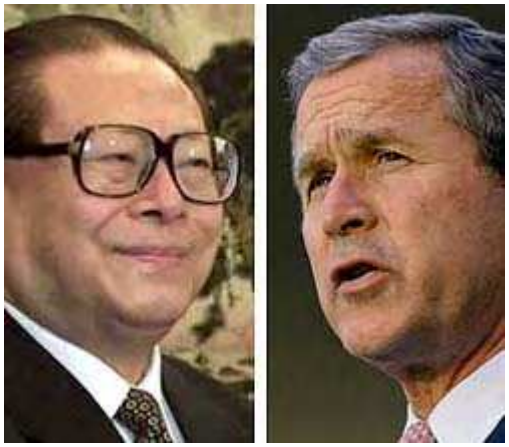
But American officials tell it differently. They say the Chinese pilots were probably to blame for flying recklessly close to the slow-moving, propeller-driven EP-3 as it lumbered through international airspace. The damaged plane entered Chinese airspace only after the accident and was, say American spokesmen, entitled to make an emergency landing after issuing a Mayday alert.

American officials are appalled at the thought of so much state-of-the-art spy gear falling into Chinese hands. They have insisted that China should allow the plane full "sovereign immunity" and leave it alone. Western legal experts consider that argument something of a stretch (see article). China, clearly, is not convinced either.

Reuters

Chinese soldiers boarded the plane soon after it landed and are thought to have spent the intervening days going over it meticulously to glean what they could about American intelligence-gathering methods and machinery. United States officials say the crew managed to destroy the most sensitive bits of data and equipment before the Chinese boarded. Even so, getting such a good look at the plane is an intelligence coup for China. American military experts acknowledge that their government would

probably have done the same if a Chinese spy plane had landed on their doorstep. No one reckons that the EP-3 will be returned soon.



Will Jiang or Bush blink first?

The treatment of the crew has been another matter. Chinese officials waited nearly three days before allowing American diplomats to visit the captured crew members, a delay described by the American ambassador, Joseph Prueher, as “inexplicable and unacceptable”. Far from revealing when they might release the crew, Chinese officials have hinted at pressing legal charges.

Not only have the two countries been trading barbs, but they have been doing it at the highest level, which may make the matter more difficult to resolve. Mr Bush and the Chinese president, Jiang Zemin, have each personally made demands that are unlikely to be met. Before leaving China on Wednesday on a two-week official visit to South America, Mr Jiang called on the United States to apologise, and refrain in future from conducting surveillance so close to China. Western diplomats say that such activity is a routine affair that will continue, and that China cannot seriously expect otherwise. For his part, Mr Bush has done nothing but repeat his stern demand that the crew and the aircraft should be released immediately so that this “accident” does not escalate into a more serious “international incident”. Colin Powell, the secretary of state, has expressed “regret” at the loss of the pilot’s life, but has offered no apology.

To Chinese ears, the American stance smacks of arrogance and insensitivity. It was the Americans, they say, who conducted a spy mission provocatively close to China, and it is a Chinese pilot who is missing. A Chinese foreign ministry spokesman, Zhu Bangzao, said this week that America ought not to be putting forth “all manner of requests”, but rather should accept responsibility and yield to China’s demands. All of this goes down well with a Chinese public that is traditionally and increasingly prickly over perceived international slights of any sort, especially American ones.

When American warplanes destroyed part of the Chinese embassy in Belgrade during the NATO air campaign in Yugoslavia in May 1999, Chinese mobs, bused in by the authorities and given useful slogans to chant, demonstrated violently for four days outside the American embassy in Beijing and at its consulates in other cities. America’s efforts to explain the bombing as an accident resulting from faulty map work only angered people further. The government, meanwhile, did nothing to dispel the common belief that the Americans bombed the embassy in an act of bullying.

Chinese Internet chat rooms have been buzzing this week with angry accusations comparing the spy-plane episode to the embassy bombing, and urging similar demonstrations. So far only a handful of protesters have tried to reach the American embassy in Beijing, and they were stopped by police. But an increased police presence in the diplomatic quarter, and the quiet contingency planning now under way among embassy staff, suggest that an eruption of new demonstrations seems possible to both sides.

That will happen, however, only if the Chinese government signals its approval, and the easiest way for it to do that would be to fill the state-run newspapers with emotionally charged reporting about the missing navy pilot, and about American culpability for his fate. Given the intense pressure coming not only from an angry public, but also from its own hawkish generals, the Chinese government may fear a backlash if it attempts to suppress such passions. At the same time, it knows that stoking them will harm its reputation abroad. Seeking to enter the World Trade Organisation this year, and to gain the prize of the 2008 Olympics, China’s leaders will be wary of risking an outburst that could get out of control.

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Questions of blame

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From The Economist print edition

WHO is in the right in the spy-plane drama? On past practice, the United States was in a strong position to demand the immediate return of the aircraft, but it would be hard to argue that the Chinese had no right to inspect it carefully.

During the cold war, and sometimes since then, a number of Chinese fighter pilots defected to Taiwan, where a reward awaited them. Soviet airmen too would occasionally fly to the West. In those instances, the stolen aircraft was returned to its owner, but not before the “host country” had examined it closely, according to Andrew Brookes, of the International Institute for Strategic Studies in London.

On the question of who is to blame for the collision, the “rules of the air”, applicable to civilian as well as military planes, lay down that if an aircraft is shadowing another it must keep at a safe distance. The American version of events would suggest that this particular Chinese pilot—not for the first time—broke this rule.

On the other hand, the Chinese could argue that they had acted properly in granting emergency landing rights to the spy plane, something any country is obliged to do for an aircraft of any other country, whatever the state of their relations. China could also cite a host of technical grounds for inspecting the spy plane carefully, including health and safety procedures. Not many people would take seriously the United States’ claim that its aircraft was “sovereign territory”, at least in the sense that an embassy is.

But nothing quite like this has happened before. The most memorable previous incident—the shooting down and capture of an American airman, Gary Powers, in the cold-war days of 1960—was different because his spy-plane was clearly flying in Soviet airspace.

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Private Bill

Apr 5th 2001 | DELHI
From The Economist print edition

AS A change from Washington, DC, where a new man is now having to answer the difficult questions, Bill Clinton slipped off to India this week, planning visits to the earthquake-devastated state of Gujarat and a Mother Teresa home in Calcutta. He was with a group of Americans of Indian descent who have raised over $15m to help earthquake victims. Among them were several Silicon Valley software billionaires and Rajat Gupta, managing director of McKinsey, a management consultancy. His publicity was being looked after by a team provided by Victor Menezes, head of Citibank's emerging-markets business.

Mr Clinton's aim is apparently to emulate, with perhaps more style, the success of Jimmy Carter, another former president, who has created a role for himself as an international mediator. India loves icons, as Mr Clinton discovered on his triumphal presidential visit in March last year. But when India eased a host of restrictions on imports this week, it was hoping to acquire the most modern goods and technologies from abroad, not those that have passed their best-before dates in the West. It waits to see if Mr Clinton will do more than generate personal publicity.

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Japan

Bad blood

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From The Economist print edition

ETSUKO KAWADA does not know the exact year her son was infected with the HIV virus. But most of the 1,400 haemophiliacs in Japan who contracted HIV through contaminated blood products got the disease in 1983, when Ryuhei Kawada was seven years old. Eighteen years later, the doctor at the centre of this tragedy has at last been tried for professional negligence. The prosecutors had demanded a three-year prison sentence. Yet, when the trial ended on March 28th, Takeshi Abe was aquitted.

Suspicions over Mr Abe's conduct centred on delays to the government's authorisation of safe treatments for haemophiliacs. In March 1983, the United States' Centres for Disease Control reported that HIV was being transmitted to haemophiliacs through unsterilised clotting agents. The same month, the American Food and Drug Administration authorised the use of a safe, heat-treated blood product. Japan did not authorise heat-treated products until July 1985. Ryuhei Kawada was switched to a treatment of that sort in September 1985, long after doctors in America had stopped using unheated blood products.

A leading haematologist, Mr Abe was also head of the health and welfare ministry's AIDS research panel, which met for the first time in June 1983. At that meeting, according to a tape-recording seized by public prosecutors during a raid on the ministry, Mr Abe expressed strong reservations about the safety of unheated blood products, saying, "I inject [the product] every day, thinking there is a toxic substance in it." Later, however, Mr Abe seemed to change his mind. Guidelines drawn up by two of his subordinates, for example, recommended testing the new, sterilised clotting agents for six months before approval. Mr Abe insisted on one year of trials. He stuck to that decision, though six months of testing had given excellent results by November 1984.

Separately, two of Mr Abe's junior colleagues also testified that they had suggested he should switch to an older, but safe, clotting agent. Mr Abe overruled them. The most extraordinary aspect of the recent judgment, says Yoshiko Sakurai, the author of two books on the subject, is that it failed to touch either on the unusual details of Mr Abe's case, or on the question of his motivation. Mr Abe was accused of causing the death of a patient who had been injected with contaminated blood products in May and June 1985, a lot later than most other haemophiliacs. By this time, two of Mr Abe's patients had already died of AIDS. Yet Mr Abe still prescribed the unheated blood product. In his ruling, the judge made no explicit reference to that case.

He did, however, argue that, although Mr Abe was aware of the danger of HIV infection, he could not have anticipated the consequences of the disease, because so little was known about AIDS. The judge dismissed the evidence of Mr Abe's two colleagues as lacking credibility. They testified, he suggested, to save their own skins.

Nor did the ruling deal with the question of Mr Abe's motivation. Prosecutors had sought to show that Mr Abe had delayed the introduction of heat-treated clotting agents in order to help out Green Cross, a Japanese pharmaceuticals company. Green Cross had invested heavily in unheated products. The firm also trailed behind its competitors in the development of sterilised blood products. Mr Abe enjoyed close relations with Green Cross. Between June 1983 and November 1984, for instance, he received ¥18.5m ($75,000 then) from Green Cross, as well as money from other drug companies. The Green Cross donations went towards conference and symposium costs and an endowment fund that supported Mr Abe's foundation. This foundation promoted the use, at home, of unheated blood products.

Some good has come from the tragedy. The health ministry's continuing attempts to cover up the truth have caused Japan's deferential voters to look at their government through new eyes. Last year, Mrs Kawada became a member of parliament, from where she campaigns on human-rights issues. Her son Ryuhei is a focus for protest at the often arbitrary and unaccountable exercise of power, in many fields, in Japan.

There is much to protest about. Since 1972, according to the health ministry, not a single Japanese

doctor has lost his licence for professional negligence, though nearly 50 have for other reasons. The newspapers, meanwhile, are full of stories about mistakes at hospitals and subsequent cover-ups. Mr Abe's judge said the law should not hold one man responsible: a nod, perhaps, towards the importance of collective responsibility in Japan. But by all accounts, Mr Abe did not take decisions collectively. Certainly Mrs Kawada does not buy it. "Japan is lenient on people with authority," she says.

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India

Capital punishment

Apr 5th 2001 | DELHI
From The Economist print edition

BUSES were being stoned and set on fire in Delhi this week in a sharp escalation of a battle over fuels. The attackers were mostly owners of buses run on highly polluting diesel fuel. The assaulted buses were powered by environmentally friendly compressed natural gas (CNG). Angry crowds deprived of transport joined in the violence. Police fired over their heads to disperse them.

AP

Climb on, it's not a pollutant

The conflict dates from three years ago, when India's Supreme Court ordered all of Delhi's 12,000 buses to be converted to CNG from diesel, in an attempt to rescue the capital from its plight as one of Asia's most polluted cities. But little progress has been made. The court tried to speed matters up and almost brought Delhi to a stop.

The court first became involved in 1996, when an environmental lawyer, M.C. Mehta, brought an action against "the Union of India and others". He called for measures against decrepit buses, whose diesel fumes had helped to raise the level of pollution to three or four times the permitted level.

In 1998, the court ruled that diesel should be replaced as the bus fuel, either by converting existing engines or by replacing the buses. But neither the Delhi state government's bus service nor private bus owners took much notice, and manufacturers of CNG engines and conversion kits did not gear up production lines, because there was little prospect of orders.

Judges in India often relax their rulings if those involved are showing sincerity of purpose. But with little evidence of that, the court set a deadline of March 31st for a complete changeover, by which time only 200 conforming buses were available. The deadline galvanised the government and private bus owners into action, so the court, seeing some display of sincerity, set a more realistic date of September 30th. But it insisted that only those buses that were using CNG, or whose owners had permits to prove that they had placed orders, could ply the streets.

By Tuesday this week, when Delhi emerged from a long holiday weekend, only 1,500 buses were on the roads. Passengers clung to the sides of buses or crowded on to the roofs, while those inside were charged higher-than-usual fares. About 50 buses were stoned or set on fire.

The Delhi government, seizing on the unrest as an excuse to defy the Supreme Court, allowed buses to return to the streets on Wednesday, even if the owners had not obtained permits to prove that they had ordered CNG engines. That meant that 9,000 buses were back on the streets, and the court agreed to extend the deadline for acquiring permits to April 15th.

Delhi's 50,000 taxis and auto-rickshaws are also affected. After another Supreme Court action, several thousand are proudly displaying bright green stripes to show that they have abandoned diesel for CNG. But there are not enough CNG filling stations to meet demand and long queues have built up outside the 50 existing stations.

Judicial activism has grown over the past 25 years. Judges, much criticised during the country's 1975-77 state of emergency, have rebuilt their reputations by responding favourably to public-interest litigation. Early cases involved human-rights issues, such as bonded labour. They were followed by environmental and corruption cases. In 1996, a judge in Delhi went into her court one morning and started her own case against the municipal authority for creating a health hazard by allowing rubbish to pile up in the streets. The rubbish was rapidly cleared.

Such intervention frequently leads to opposition. There were street demonstrations over job losses after the courts ordered all polluting factories or workshops out of Delhi last year. However, several thousand of the worst offenders, out of a total of some 100,000, have gone from the city.

All of which, says Abhishek Singhvi, a lawyer who formerly worked for the government, makes India's one of the most dynamic judicial systems in the world: judges, unlike Delhi's traffic, get things moving.

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Vietnam

A violent mix, land and religion

Apr 5th 2001
From The Economist print edition

New protests as Vietnam prepares for a party congress

IS IT just another clash between religious groups and Communists, or a real challenge to the government? As in China, Vietnam's leaders have never been tolerant of religions and, as in China, they are now confronting a cult with worrying partners abroad. Not the Falun Gong here, but Christians. For several months, officials and police have cracked down on Protestant ethnic groups in the remote central highlands. In Dhalak and Gia Lai provinces, they have torn down makeshift churches defended by stone-throwing youths. Many people have been injured and, according to one report, eight have been killed.

AP

Hill people are different

Although the protests are unusually large, the apparent problem is not new. Vietnam's secular party leaders find religion a pain, so seek to keep the country's 8m Christians in check. Most are Roman Catholic, as a result of French colonial rule. But there are also 250,000 Protestants, mostly among the ethnic minorities who make up roughly 15% of the population of 80m. For all denominations, party officials grant, or withhold, permission for churches to be built, and meddle in the appointment of clergy. This week, for example, the government said it would extend official recognition to the Evangelical Church of Vietnam. That gave legal status to the group, which represents about 250 protestant congregations.

Buddhism presents bigger difficulties. The party is envious of the large congregations that still flock to temples, despite decades of official discouragement. Around half of Vietnam's people are Buddhist. In March a Buddhist sect was outlawed when its leaders organised a rally in Ho Chi Minh City. The authorities said they were planning mass suicide, pointing to the self-immolation of a woman in the sect. She was protesting at the arrest of a Buddhist leader, Le Quang Liem, an octogenarian.

Buddhist monks are routinely detained. As in its dealings with Christians, the Communist Party interferes with the running of the Buddhist order, claiming the right to appoint abbots at monasteries. Despite government assertions that Vietnam allows generous and growing religious freedom, Human Rights Watch, a monitoring group based in New York, suggests in a recent report that it remains sharply curtailed.

But religion only partly explains the troubles in the central highlands. The government blames foreign agitators, especially Americans, for stirring up the hill folk. To a limited extent, foreigners do indeed hold some influence. The hill tribes, collectively known as Montagnards, had close ties with American forces before the unification of Vietnam in 1975. Today, many have relations in the United States, where the Montagnard Foundation, in South Carolina, campaigns on their behalf. The executive director, Kok Ksor, admits that he advises protesters by telephone on how to confront the officials peacefully and in unity.

Land, he says, is a bigger problem than religion. "If somebody takes our land away, they take our life away." The hill tribespeople say that large numbers of lowland Vietnamese are migrating to higher ground and threatening their traditional way of life. Lowlanders, who see ethnic minorities as backward, are clearing land and forest to make way for plantations of coffee, which does well in the cooler climates higher up, and for other cash crops, all of them valuable for the export market.

Such deforestation in the hills is a contributory cause to the floods that now

strike Vietnam nearly every year. And clashes over the land itself have generated unusually open dissent in many parts of the country. In the past few years, disgruntled, land-hungry farmers have marched into Hanoi, the capital, and into the largest town, Ho Chi Minh City, to stage demonstrations, sometimes lasting for several weeks at a time.

While acknowledging that such protests take place, the government tries to play them down, though its television station did show a few seconds of footage of the recent riots. State-controlled newspapers blame “reactionary elements” for causing trouble. But party leaders are preparing for their five-yearly congress, which is due to begin on April 19th. That big political set-piece makes the party even more than usually sensitive to signs of protest.

In a typically communist response, a propaganda unit from the army has been sent to the highlands to “educate” the tribespeople. Meanwhile, local authorities have been forced to admit “errors”, and a minister for ethnic affairs, Hoang Duc Nghi, has been ticked off. A party newspaper, *Nhan Dan*, last week scolded officials who have “stayed away from the people and have not really understood all the difficulties they face”. The government seems to be trying to meet some of its citizens’ grumbles, but complaints about land or religion, or both, are likely to continue until well after the party congress is finished.

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Berlusconi's bandwagon rolls across Italy

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From The Economist print edition

With pollsters still predicting a win for Silvio Berlusconi, a right-wing media magnate, in next month's Italian general election, a new team to run the country is limbering up

Get article background

ITALY'S first experience of Silvio Berlusconi as prime minister, in 1994, ended in disarray within months because his coalition was rickety and quarrelsome, the people he put in charge of ministries were a rum and inexperienced lot, and the programme on which he had been elected was more hot air than substance. This time, so far, things are looking a bit different.

If he wins next month's general election, as all pollsters predict, his two main partners, the post-fascist National Alliance, led by the canny **Gianfranco Fini**, and the federalist-but-no-longer-separatist Northern League, led by the rowdy **Umberto Bossi**, are more tightly bound to Mr Berlusconi's own Forza Italia (Let's go, Italy). They have signed a pact laying out clear if simplistic policy guidelines. Mr Berlusconi seems to be assembling a weightier team, which, thanks to a recent reform, will limit the next cabinet to just a dozen people. And in ordinary Italians' eyes many faces in his line-up have a fresher look than those on the left, whose leading lights have been around much longer.

Another novelty is Mr Berlusconi's determination that all party chiefs in his House of Freedoms coalition should have ministerial jobs, so that they cannot run their parties while sniping at government from outside. So this time Messrs Fini and Bossi will each have to become a deputy prime minister.

The leaders of two smaller parties who have signed up with Mr Berlusconi are also tipped to get jobs if he wins. **Pierferdinando Casini**, who leads the small Christian Democratic Centre, a spin-off from the old Christian Democratic party that fizzled out after the corruption scandals of the early 1990s, hopes to become defence minister. **Giorgio La Malfa** of the little Republican Party, a free-market, liberal outfit that has tended to back the centre-left but has controversially switched horses this time, hopes for a nice job too. **Rocco Buttiglione**, an evangelical type who is close to the Vatican and heads another Christian Democratic offshoot in cahoots with Mr Casini's, wants to run education: the right's proposal to give public money to help finance private schools is one of the few policy questions to stir debate during the campaign.

But whom would Mr Berlusconi, as prime minister, actually listen to? **Giulio Tremonti**, a rich Milanese tax lawyer and professor, aged 52, who was finance minister in 1994, is certainly one. He is expected to run the Treasury merged with the Finance Ministry. Shrewd and steady, and likely to echo the voice of Italian business, he advises Mr Berlusconi on a range of issues. He is credited, among other things, with

pinning down the Northern League with a much clearer agreement than last time's. Friends say he speaks to the "northern" (that is, the down-to-earth, practical, Milanese) bit of Mr Berlusconi's heart. They say that **Gianni Letta**, a suave former Christian Democrat who may run Mr Berlusconi's office, will tune into the "southern" part of his boss's nature: Mr Letta is a wily political fixer who knows the corridors of Rome backwards.

If Mr Berlusconi does win, two other people may influence the way he governs. One is **Giuliano Urbani**, a political scientist who may even have been first to suggest that Mr Berlusconi should invent a new party and jump into the vacuum left by the ruins of the old centre-right establishment in the early 1990s. Mr Urbani is fancied to become parliament's speaker. The other is **Claudio Scajola**, who runs the Forza Italia party machine; he might like the Interior Ministry—but so might **Franco Frattini**, who has been chairing parliament's security-services committee. Another influential job will be the justice minister's. The judiciary needs a drastic overhaul, and **Marcello Pera**, an early Forza Italia backer who belongs to a group known as *i professori*, may be asked to effect it.

One post not yet spoken for is the foreign minister's. Mr Berlusconi had hoped to entice clever **Mario Monti** into taking it. Sent to Brussels as an EU commissioner by Mr Berlusconi in 1994, he now runs competition policy there—and seems in no hurry to return. An alternative could be the outgoing prime minister, **Giuliano Amato**. But **Renato Ruggiero**, a tough Neapolitan, who till recently headed the World Trade Organisation and now works for a merchant bank in London, could yet be the man.

A sturdier platform

Three main pillars would bolster a Berlusconi establishment: business, the media and regional powers. All would be propped up by his trustiest old pals.

In 1994, many in Italy's old business establishment were wary of Mr Berlusconi, viewing him as a vulgar upstart. Now reckoned to be worth at least $10 billion, he has drawn it lock, stock and barrel on to his side, with promises to slash taxes, cut red tape, face down the trade unions and spend more on infrastructure. Even Fiat's **Giovanni Agnelli**, long the country's most influential tycoon, who has usually backed the centre-left, is said to be cosying up to Mr Berlusconi.

The aspiring prime minister won a rousing reception last month in Parma, when he addressed Confindustria, the businessmen's national club. Most of Italy's industrialists love Mr Berlusconi. Recently **Bernardo Caprotti**, owner of the Esselunga supermarket chain, asked a bunch of friends to dine with Forza Italia's leader in Milan. "It was unbelievable," said one of the tycoon's confidants. "You had 3% of our GNP sitting round the table with him."

The second pillar beneath Mr Berlusconi is composed of regional and local bigwigs. Regional presidents and city mayors have gained more clout in recent years, and several right-leaning ones could be called to national office. But Mr Berlusconi may be happier to keep the beefier ones where they are: for instance, **Gabriele Albertini**, Milan's mayor; **Roberto Formigoni**, Lombardy's president, who had hoped for a ministry but is now being investigated by Milanese magistrates; **Giancarlo Galan**, a former advertising executive for Mr Berlusconi, who presides over the rich Veneto region; and the youthful **Raffaele Fitto**, president of Apulia. If a Berlusconi government were to boost the devolution bill recently passed by the outgoing parliament—without Forza Italia's backing—such people could gain still more in stature and influence.

The third and perhaps sturdiest of the pillars on which Mr Berlusconi's power will rest is the media—especially the many outlets he owns through his Mediaset company. From those stables he could well rely on journalists to help polish his image and spin his tale. **Paolo Guzzanti**, deputy editor of *il Giornale* (which Mr Berlusconi happens to own), is running for the Senate. Others whose thoughts Mr Berlusconi takes to heart are **Giuliano Ferrara**, editor of *Il Foglio*, whose chief shareholder is Mr Berlusconi's wife; a television anchorman, **Maurizio Costanzo**; and **Gianni Baget Bozzo**, a pundit and former priest. **Paolo Bonaiuti** is likely to remain his trustiest spokesman. With such backing from the myriad bits of the media that he owns, Mr Berlusconi hardly needs any extra help from the press.

Loyalty, his best asset

In any event, if the going got rough, he would probably fall back on his oldest pals for advice and

comfort. Some, however, who were prominent seven years ago, have been judiciously sidelined. **Marcello Dell'Utri**, a book-collecting Sicilian who once ran Mr Berlusconi's advertising empire, is standing for parliament while on trial for having Mafia connections. Another old friend standing for parliament but not for office is **Cesare Previti**, Mr Berlusconi's lawyer who held the defence ministry in 1994 but is also on trial, for alleged bribery.

And don't forget **Fedele Confalonieri**, the magnate's oldest friend, who tinkled the ivories when Mr Berlusconi was a cruise-ship crooner. He will go on running the Mediaset empire. With three television channels at his bidding, that will be no small task in Mr Berlusconi's heralded new world.

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No German children? Then pay up

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IN A startling decision this week, Germany's Constitutional Court ruled that workers with children should pay a lower premium for the country's compulsory nursing-insurance scheme than childless ones. The ruling, in a case brought by a father of ten and by family associations, has wide implications for other parts of the country's welfare system, notably pensions. Nothing has been said about the other solid financial and non-financial benefits already enjoyed by parents.

According to the court's eight judges, the present pay-as-you-go insurance scheme, set up in 1995 to provide long-term nursing care for the elderly and chronically sick, is unconstitutional, because it has failed to promote the family or to ensure equality before the law, as required by the constitution. Since the main future beneficiaries of the scheme will depend on the premiums paid by coming generations of workers, those people who have not helped to maintain the number of future contributors—ie, the childless—are getting an unfair financial advantage, says the court. So they should pay more.

The present system might have been acceptable in an earlier age when relatively few adults remained childless, said the court, but not at a time when many couples were making a deliberate decision not to have children. Over the past 30 years, the number of babies per woman has fallen by half to 1.3%, one of the lowest rates in the European Union. One woman in three of child-bearing age now remains childless. Experts say that to stabilise the age structure of the population, German women would have to start having 3.8 children apiece, or huge numbers of young immigrants would have to be admitted.

To give the government time to consider the ruling's significance for other branches of the welfare system, the judges suggest that the present flat-rate levy of 1.7% of gross wages should be maintained for the nursing-insurance scheme until the end of 2004. Thereafter, parents should pay less than single people or childless couples. How much less, the judges have not said; nor—and it's a fair question—whether parents with only one child should pay more than those with ten.

German parents are already well treated by the state. They get a tax-free benefit of DM270 ($122) per month for each of their first two children, DM300 for the third, and DM350 for each later one, up to the age of 18—indeed, until 27 if the child is still in full-time education. They get other tax breaks too. Parents willing to take time off work to look after their children at home are eligible for additional grants of up to DM900 a month during the child's first year.

And so on. And on, maybe, if lawyers get their hands on such issues. As in most countries, Germany's childless—or various other categories who may feel disadvantaged by this or that aspect of the tax-and-spending system—have generally accepted that they must take the rough with the smooth.

But already there are signs that the principle set out by the court is provoking thoughts of "sauce for the goose, sauce for the gander". As for the happy father of ten, shouldn't he be charged arrears of contributions if all ten turn out to be unemployable, or emigrate?

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Hungary

Ethnic pitch

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AP

Orban, grinding for the Magyars

THE women clad in traditional floral dresses and headscarves who sell earthenware plates and shawls to tourists near the foreign ministry may soon get a warmer welcome in Hungary's capital. For they are Magyars, or ethnic-Hungarians, who come from parts of present-day Romania that fell within Hungary's borders until 1918, and are therefore among some 3m-4m would-be beneficiaries of a plan by the country's right-wing government, led by Viktor Orban, to boost the lot of ethnic-Hungarians across Central Europe. The government says it is merely seeking to do its duty to protect Magyars who live outside Hungary. Some in the opposition, however, say the plan is a nationalistic ploy by the right to win votes at Hungary's next general election, due in a year's time.

Many Magyars, be they citizens of Romania or elsewhere, already depend on Hungary for business. They work illegally on Budapest's building sites. Many help bring in the harvest from Hungary's farms. Now, under the proposed new law, they would become eligible for education and health benefits, employment rights and a batch of other perks. Next year, says the government, special cards to confer such rights—though not the right to vote—would be issued. Many thousands of grateful Magyars, hopes Mr Orban, will claim them before the next general election.

The law certainly touches a ticklish problem for Hungary as it strives to join the European Union. At present, all citizens of neighbouring countries that have notable minorities of Magyars—Romania, with more than 1.6m of them, Slovakia, with 600,000, Yugoslavia, with 300,000, and Ukraine, with 200,000—can move freely in and out of Hungary. But once Hungary joins the EU, the citizens of several of these countries, though probably not Slovakia, may need visas.

Zsolt Nemeth, a junior foreign minister whose father came from Transylvania, the western bit of Romania that now abuts Hungary, says that without the new law many thousands of desperate ethnic-Hungarians might surge into Hungary before it joined the EU. So the law would let ethnic-Hungarians work legally in Hungary for three months a year while helping them financially to sustain their way of life when back home. Three months' wages in booming Hungary, Mr Nemeth says, are enough to live on for a year in much poorer Ukraine or Transylvania. But the EU dislikes the proposed law, since it would sanction ethnic discrimination in the labour market between citizens of neighbouring countries.

In any event, some Hungarian opposition MPs on the left and in the centre doubt whether the law would solve the Magyars' problems. Istvan Szent-Ivanyi, a former foreign minister who now heads parliament's foreign-affairs committee, says that Hungarian employers, who use foreign Magyars mainly as cheap labour, are unlikely to pay their tax and social-security contributions just because the new law would allow them to; and without such payments, Magyars would be unable to take advantage of Hungary's health service, except through a special fund whose largesse will be dished out by a committee likely to be packed with government nominees. Mr Szent-Ivanyi worries that the recipients would become part of a new kind of government clientele.

For the most ardent nationalists, however, the bill is still too weak. For instance, Miklos Patrubany, the president of the World Federation of Hungarians, a radical ethnic-Hungarian lobby group, says that the EU should simply admit all 3m-4m Magyars who now live outside Hungary, on top of the 10m people already in the motherland: not a plan that EU countries are likely to look upon at all benignly.

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Charlemagne

Alain Richard, France's agile defence minister

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From The Economist print edition

THE minister, normally a picture of elegant good health, for once looks a trifle weary. Perhaps it is the constant pressure of directing France's armed forces, flying hither and yon—to Kosovo and Bosnia, yet again, this week and then, yet again, to Brussels—dealing with stroppy Russians or suspicious Americans, placating members of the National Assembly and, above all, trying to realise the dream of a Europe able to fight on its own behalf.

But maybe Alain Richard, minister of defence for the past four years, is simply suffering a touch of post-campaign blues. The Socialist-led government, of which he is a leading light, dreamed of sweeping the country in last month's local elections. Instead, the right held its own, and even gained a little. Mr Richard easily won the vote to be mayor of St-Ouen-l'Aumône, a scruffy, industrialised place just north of Paris, but failed in his parallel bid to be president of the regional council.

But his personal disappointment will fade, and anyway is somewhat beside the point. The prime minister, Lionel Jospin, rejecting the tradition of the *cumul des mandats*, by which France's politicians pretend to fill several offices at once, told his electioneering ministers they could choose national office or local, but not both. Happily for Mr Jospin, who might be hard-pressed to find an adequate replacement, Mr Richard has quickly plumped for a continued stint at defence.

Happily for foreigners, too. If there is one man who can finesse the architectural difficulties of building a security and defence policy for the European Union, it is perhaps Mr Richard. Now 55, he is unmistakably part of the French elite: Paris's Henri IV *lycée* for his teenage years; a degree from the capital's Institut d'Etudes Politiques; the almost obligatory spell for the very best and brightest at the Ecole Nationale d'Administration (ENA); and then membership of the Conseil d'Etat, the Council of State, the ultimate overseer of French politics. But, thanks to boyhood spells in Britain, he is also fluent in English, and he is likeable—qualifications that count in the search for common ground among politicians, generals and diplomats on both sides of the Atlantic. In short, Mr Richard is better placed than most to straddle the gap between France and an English-speaking world seen both as ally and rival.

That gap represents decades of mistrust. Think back, for example, to the 1950s, when the proposed European Defence Community foundered in part because the French had one idea of the role of German troops (they feared a German resurgence), and the British and Americans had another. Or to 1966, when General de Gaulle, ever resentful of American "hegemony", pulled French forces out of NATO's integrated military structure, albeit not its political bodies. Or even today, when it is fashionable to criticise globalisation as Americanisation. The unsurprising result is that a lot of Americans, and quite a few Britons, believe the European Union's proposed rapid-reaction force is a French plot to found a European army which, ultimately and inevitably, will destroy the North Atlantic alliance.

Alarmist nonsense, retorts officialdom in Paris. Indeed, self-contradicting nonsense. How, ask Mr Richard and his European counterparts, can the United States demand more "burden-sharing" by the Europeans, and then bemoan Europe's effort to do it? All the EU has in mind is that by 2003 there should be a force of 60,000 troops, deployable within 60 days for situations, from the military to the humanitarian, in which NATO as a whole is reluctant to intervene. The force will be a complement to NATO, not a competitor. "I want to be clear," says Mr Richard. "No European country would have agreed to take part in building a European defence structure if it meant a relaxation of the transatlantic link."

Ah yes, but the devil is in the details, and not all of them are under Mr Richard's control. Did not Jacques Chirac, France's Gaullist president, declare at the EU's Nice summit in December that the rapid-reaction force should be "independent" of NATO in "its planning and implementation"? Mr Richard, confined by the electorally enforced coexistence of a right-wing president and a left-wing government, keeps an eloquent silence.

Meanwhile, there are other details to deal with. Of course France worries that the Bush administration's

plans for a “son-of-star-wars” anti-missile shield might upset, to Europe’s detriment, the balance between Russia and America, but a lot will depend on the scale of that shield. Will George Bush, having promised to raise military wages, have enough money for a truly grand project? And if he tries to cut costs by offering part of the work to his European allies, will they want it, or be able to afford it?

Mr Richard, having seen five American administrations during his quarter-century in politics—he was an early follower of Michel Rocard, one of France’s more go-ahead Socialists—is ready to wait and see. Sensibly, for much in his field is unclear. How will the Bush administration bed down? Will Mr Putin’s Russia choose co-operation or confrontation in dealing with the West? Will Turkey lend its support within NATO to the EU’s rapid-reaction force? Besides, the unexpected can always throw a spanner in the works: witness the French parliament’s decision in January to describe as genocide Turkey’s treatment of its Armenians nearly 90 years ago—and so to prompt today’s Turks, who still deny it, to have angry second thoughts on the rapid-reaction force.

Meanwhile, for all the occasional local difficulty, such as broken propellers on a brand-new aircraft carrier or tales of bullying at a military college, Mr Richard surely has a right to relax a bit, to banish the rings beneath his eyes. The armed forces are being modernised and Mr Chirac has helped by ending conscription; Franco-British defence co-operation, sealed with the St Malo accord in December 1998, is on track, despite the efforts of Britain’s tabloid press; with luck, the EU’s rapid-reaction force has enough momentum to overcome the doubters. Why not, muses the minister, take some spare time to add German to his list of languages? Hm. He may look tired, but appearances are evidently deceptive.

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Dark Morning in Turkey

Apr 5th 2001 | ANKARA
From The Economist print edition

THERE is nothing odd about journalists in Turkey being put behind bars for things they write or say. But last week the owner of one of Turkey's most widely read daily newspapers, *Sabah*, was sent to an Istanbul prison after appearing in a special security court not for his views but for his alleged role in shady business dealings. The arrest of 61-year-old Dinc Bilgin, scion of a dynasty of journalists from the Aegean city of Izmir, could mark a turning-point for the Turkish media. Mr Bilgin is accused of siphoning hundreds of millions of dollars from Etibank, a private bank his group controlled until it was taken over by the government last October, to prop up his other business interests.

What they read

Name	Meaning	Ideology	Owner	Circulation*
Hurriyet	Freedom	Right	Dogan	640,000
Sabah	Morning	Right	Sabah	470,000
Posta	Post	Pro-establishment	Dogan	393,000
Turkiye	Turkey	Nationalist right	Ihlas	353,000
Milliyet	Nationality	Pro-establishment	Dogan	337,000
Aksam	Night	Right	Cukurova	248,000
Cumhuriyet	Republic	Pro-secular left	Journalists' co-operative	45,000
Radikal	Radical	Liberal	Dogan	39,000

Source: Yaysat (distribution company) *January 2001

Back in 1985, when he launched *Sabah* ("Morning" in Turkish), Mr Bilgin was hailed as a hero for his unprecedentedly brave exposure of the scandals engulfing the prime minister of the day, Turgut Ozal. But then Mr Ozal, who later rose to the presidency, shovelled out some $3 billion-worth of subsidies to newspapers in a Faustian deal. Two media groups, *Sabah* and its rival, *Dogan Medya*, snapped up the lion's share to invest in new high-tech printing plants. Such was the sudden opulence at *Sabah* that an ex-employee recalls "relieving myself in imported Italian porcelain".

The Dogan group—named after its owner, Aydin Dogan—did particularly well. It is now said to have nearly two-thirds of total newspaper advertising revenue and the largest slice (nearly half) of the daily circulation pie, with shares in nine newspapers, not to mention 31 magazines and seven television and three radio stations. Like Mr Bilgin, Mr Dogan branched out into banking with the purchase of a small bank, Disbank, a couple of years ago.

As the media moguls grew fat on government subsidies, their political indebtedness to a succession of governments grew too. Zealous reporters who uncovered dirt on crooked politicians soon found their stories being spiked. Some popular columnists, such as *Sabah*'s Cengiz Candar and Mehmet Ali Birand, were not only sacked but, with a wink from the army's top brass, who disliked their liberal views on restive Kurds and alienated Islamists, were even attacked in articles in their own paper.

Mr Bilgin's arrest, however, shows that the media moguls may no longer be able to count on the politicians for protection. Already in December Sedat Nuri Kayis, chairman of the state broadcasting watchdog, had revealed to a parliamentary commission that the large media holdings repeatedly break laws that ban groups with more than a 10% stake in radio and television stations from competing in government tenders.

They are likely to lose even more influence because of the economic crisis that hit Turkey in February. The Turkish lira has slipped by more than 80% against the dollar, inflation has resumed its upward spiral, and tens of thousands of Turks have lost their jobs, including some 3,000 media people. No wonder newspaper sales are slipping. To add to their woes, it is reckoned that around 2m Turks now use a growing number of independent (and free) Internet news sites, which have so far managed to avoid the grip of Turkey's harsh broadcasting and publishing laws.

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Ukraine

Pipe dreams

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From The Economist print edition

THREE bits of pipe at the water company's headquarters explain the city's history better than any textbook. The first, more than a century old, is a magnificent piece of Habsburg ironwork installed in the Austro-Hungarian provincial capital, Lemberg. Next to it is another solid piece of pipe, laid down in the years between the world wars, under Polish rule, when the same city was Lwow, pronounced Lvoof. The third exhibit looks as if it had been attacked by metal-eating weevils. Installed only 20-odd years ago in Soviet-ruled Lvov—as the Russians, and most West Europeans, still call the city—it was poorly cast in cheap, soft iron. Now it is red with rust and full of holes. Such leaky pipes mean that many households in today's Lviv, the Ukrainians' name for their leading western city, have water for only a few hours a day.

EPA

Nationalists in Lv*v

Western Ukraine, sometimes called by its old name of Galicia, differs sharply from the rest of the country, and not only in having a few bits of decent pre-Soviet infrastructure. The way people think and behave is less Soviet, more Central European. Students from Lvov's universities have played a big role in recent demonstrations against the country's corrupt and authoritarian rulers. When some were arrested and mistreated last month in the capital, Kiev (Kyiv in Ukrainian), student protests in Lvov alarmed the authorities.

They responded at once. The regional administration ordered the rectors of the city's state-financed universities and institutes to stifle the protests. One, Ivan Vakarchuk, bravely said no. He argued that the country should be pleased that its young people had a public spirit. Now his university faces a tax investigation—a well-used weapon in the authorities' arsenal.

Some of the most impressively vocal and active students come from Lvov's independent theological academy, where the rector, Borys Gudziak, is an American. Agents of the Ukrainian secret police, the SBU, asked him to inform them of the students' next plans. He declined. They commented meaningfully on the quality of the renovations, implying that they might have to audit the foreign donations that paid for them. Shortly afterwards, television news reported that "rectors who are American nationals are being directly threatened with deportation". That could only mean Father Gudziak.

Although he says he has received no such threat himself, the message is clear. In the coffee houses of Lvov, optimistic Galician intellectuals see all this as a backhanded compliment. Their region, they say, is a Ukrainian Piedmont: a reference to the Alpine province that helped launch Italian statehood in the 19th century. Although western Ukraine suffered intense repression after the Soviet Union annexed it, it did not suffer the horrific artificial famine that Stalin inflicted on the rest of the country in the 1930s and that crushed the spirit of the survivors for so long. In Galicia, there is still, just, a living memory of pre-1939 capitalism and the rule of law. In western Ukraine, unlike the heavily Russified east of the country, Ukrainian is widely spoken.

So far, however, the rest of Ukraine has shown little interest in the Galicians' patriotism. Soviet propaganda portrayed the western Ukrainians as brutal, reactionary yokels. That mud still sticks. The region has little economic clout. Most big businesses are in eastern Ukraine, whose cash dominates the country's politics. Kiev rules Lvov with a heavy hand.

The students and their allies still hope that national politics will eventually go their way. They strongly support the prime minister, Viktor Yushchenko, whose government is under heavy attack from tycoons around the president. They also like Yulia Timoshenko, a former deputy prime minister who tangled with the tycoons over the country's murky energy business, ending up in jail. Briefly freed at the end of last

month after several weeks behind bars, she was promptly reincarcerated. Nationalists hope that the planned visit this summer of the pope, who is the spiritual leader for the 5m-odd Ukrainian Catholics (including 4m eastern-rite Uniates, also called Greek Catholics), will boost their cause. Most of his Ukrainian flock live in Galicia.

But it is hard to see a bunch of west Ukrainian café dwellers, even with the pope's blessing, trumping the power and money of the country's hard men and business clans. That leaves the Galicians in a pickle. A few mutter about independence. Most think that is romantic nonsense. "It plays into the hands of those who want to ditch Galicia and unite the rest of the country with Russia," says one. But many would like much more autonomy in order to get closer to the European Union and to neighbouring Poland. That might help the plumbing too.

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Russia

Repression, reform, or both?

Apr 5th 2001 | MOSCOW
From The Economist print edition

Vladimir Putin has repeated his call for reform, at the same time as encouraging the state to gobble up Russia's last independent national television company

IF IT goes according to the Kremlin's plan, Russians will soon have no choice but to watch television programmes that laud President Vladimir Putin's every move. After more than a year of wrangling, Russia's mammoth state-controlled gas monopoly, Gazprom, backed by a small American investment company, this week took over NTV, the country's last national television station that has stayed independent of the Kremlin. Meanwhile, on the same day that NTV finally lost its battle, Mr Putin made a state-of-the-nation speech in which he promised to press ahead with liberal reforms in just about every corner of Russian life.

After the NTV takeover, blood soon spattered the boardroom floor. A Gazprom man, Alfred Kokh, was given the chair in place of Vladimir Gusinsky, NTV's founder, who is in Spain fighting against a Russian prosecutor's demand that he should be extradited to face charges of fraud back home. NTV's general director, Yevgeny Kiselyov, an influential commentator in his own right, was replaced by Boris Jordan, an American investment banker of Russian origin, well-known for his involvement in controversial privatisation deals in Russia in the mid-1990s.

Journalists at NTV tried to resist the changes. They altered the broadcasting schedule, issuing only news bulletins that went on the air every half-hour. In the intervals, they beamed pictures of defiant reporters camping in their offices and small crowds of supporters in front of the NTV building. But with Gazprom and its American partner holding more than half the shares, the game at last seems to be up. The indifference that most Russians have shown towards the fate of NTV suggests that popular support for a campaign to save it would be lacking. What most Russians seem to want above all, and what Mr Putin says he is bent on giving them, is a better standard of living after a decade of horrible decline.

Addressing members of both houses of parliament gathered in the Kremlin this week, he restated his desire to slash the size of the civil service, to revamp the tax regime, to reform a judicial system that he admitted was corrupt and creaky, and to protect investors, whether foreign or Russian. Those of his compatriots who have spare cash, Mr Putin candidly conceded, are still shipping it abroad, at a rate of $20 billion a year.

Mr Putin proffered several proposals, some of them novel. The budget, he suggested, should be split into two parts: one for fixed spending, the second for dealing with surplus revenue that could be put into a special investment pot. Others ideas were variations on old themes: he said that taxes on turnover, which irk businessmen no end, should be abolished; and the number of certificates needed to start a new business—which are a well-spring of corruption—should be drastically curbed.

Mr Putin also said that currency controls, which prevent Russian citizens from legally holding accounts abroad and force exporters to sell the hard currency they earn to the state but do little to stop capital flight, should be abolished too. State monopolies, he said, should be broken up.

Mr Putin was most outspoken about the legal system. Too many laws, he said, were contradictory. Judges too often apply them arbitrarily. Prosecutors have too big an advantage over the defence. Many of the 1m-plus Russians now behind bars, he said, should not be there; and other forms of punishment should be introduced.

All fine stuff—if the words become deeds. Yet recent events, at NTV for instance, have not reassured liberals. Only two months ago the old guard managed to water down a bill to liberalise prisons, while the president was obliged to withdraw a decree that would have switched powers of search and arrest from prosecutors to judges. Nor, this week, did Mr Putin mention human rights in Chechnya, which have been treated with disdain by some Russian soldiers. Instead, ending his address, he called for a minute of

silence to honour “our heroes”.

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Greece

Pensions before Eurofighters

Apr 5th 2001 | ATHENS
From The Economist print edition

Greece has postponed a big order for new fighter aircraft—a sign of better relations with Turkey, and of more pressing welfare needs

JUST when reform fatigue seemed to be taking hold of Greece's governing Socialists, Costas Simitis, the doggedly persistent prime minister, has made a bold move. Some cabinet members were surprised to hear him announce last week that Greece would postpone a long-awaited $4.5 billion purchase of new air-force planes. The money, which would have bought about 60 of the new multinational Eurofighter aircraft, will now go to overhaul Greece's outdated pension and welfare system.

The decision displeased hawkish members of Mr Simitis's Pan-Hellenic Socialist Movement (known as Pasok), who think Greece should have as many new fighter aircraft as it can afford to fend off any possible attack by Turkey. Akis Tsochatzopoulos, the long-serving defence minister, a former rival of Mr Simitis for the party leadership, called the decision "crazy".

Mr Simitis has been careful not to cancel the Eurofighter order, for which a preliminary agreement has been signed. It is to be reviewed in two years' time. Meanwhile, other arms programmes will go ahead, including orders of American F-16 aircraft and new warships and submarines to be built or fitted out at a Greek shipyard. But with relations with Turkey on the mend, Mr Simitis reckons that Greece's air force can make do with fewer, less expensive new aircraft.

Greece, which joined the euro-zone in January, already faces problems keeping up with its obligations as the poorest member of the new currency club. It has to produce a sizeable budget surplus every year to help reduce the public debt, which is about as large as the Greek GDP. Revenues surged after American experts reorganised Greece's old-fashioned tax offices, but the surpluses are starting to flatten out. As a slowdown looms, Mr Simitis is under pressure to speed up reforms that would help make Greek companies more competitive.

The economy is expected to grow by about 5% this year, but unemployment will fall only marginally from just under 12%, mostly because comparatively few jobs are available for women and young unskilled workers. Pension reform is badly needed if the pay-as-you-go system is not to collapse in about five years' time. The Socialists are struggling to improve poorly staffed and equipped state hospitals and, at the same time, launch a family health service.

But there will be less cash flowing from Brussels, as subsidies paid to Greek farmers shrink. Controls on EU grants for improving roads and airports are being tightened, to prevent money contributed by richer north European taxpayers from being misspent.

Could Mr Simitis's decision backfire? Not if George Papandreou, the increasingly influential foreign minister, and Ismail Cem, his Turkish opposite number, keep working at improving Greek-Turkish relations. Mr Papandreou made an unprecedented overture during a visit to Ankara on April 4th: he sounded out Turkish leaders about making mutually agreed cuts in defence spending.

Such an idea would have seemed wildly out of place on his last visit to Turkey 14 months ago, when the Greek-Turkish rapprochement was still in its infancy. Since then Greece has grown more confident. Safe inside the euro-zone, the Greeks are unaffected by Turkey's financial crisis, while the Turks are under pressure from the IMF to slash their defence budget, as part of a new loan agreement.

For all his blustering over the Eurofighters, Mr Tsochatzopoulos accepts the idea that Greece and Turkey need not be enemies. He is already discussing drastic policy changes with Greece's generals, from reducing military service for conscripts to removing minefields along the border with Turkey in Thrace. If Mr Papandreou makes progress in Ankara, Mr Tsochatzopoulos should soon be back on side.

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Gordon says saving is good for you

Apr 5th 2001
From The Economist print edition

The chancellor of the exchequer wants people to save for the future. Shame, then, that his pensions policy has made it less worthwhile for many

REMEMBER “stakeholder capitalism”? New Labour’s flirtation with the idea of infusing business with compassion survives only in the name of its policy to get workers to take up private pensions. As their origin suggests, “stakeholder pensions”, which were due finally to be launched on April 6th, face more than the usual problems of reconciling private and state provision.

Stakeholder pensions are a revamped form of the personal pensions introduced by the Conservatives over a decade ago. Like personal pensions, they allow workers to build up their own pension fund from contributions that attract tax relief. However, they are designed to avoid the flaws of personal pensions—the complexity and high charges on initial contributions which encouraged mis-selling and slashed investment returns. Instead, stakeholder pensions are a standardised, cheap product with a maximum charge of 1% of the fund value. People can use them for their spouses and children as well as for themselves.

David Blake, director of the Pensions Institute at London University, says that they offer “a perfectly good replacement for personal pensions for everyone except the super-rich”. Frank Field, the minister in charge of Labour’s welfare policy until forced out in 1998, says: “I think they will sell briskly, but mainly to people outside the target group.” Mr Field believes that the principal beneficiaries will be the wives of high earners.

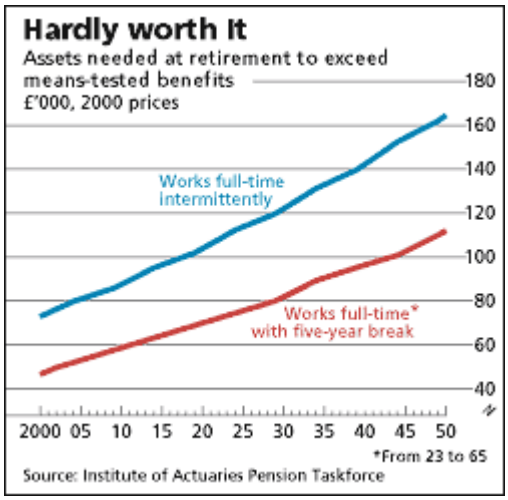
The government does not want the rich to take them up. Its target group is around 5m workers who will typically be on incomes of between £10,000 ($14,300) and £20,000 a year. Those earning more are generally in an occupational pension scheme, in which they will also benefit from employer contributions. Those on incomes below £10,000 will be better off with the state pay-as-you-go secondary pension, which will be made more generous for very low earners next year.

When the original template for stakeholder pensions was set out in a green paper at the end of 1998, the challenge of attracting the target group appeared difficult but not impossible. The proposals dangled the carrot of rebates from mandatory national insurance contributions which can be paid into stakeholder pensions. They brandished a stick, too, since reforms to the pay-as-you go secondary pension mean that those who do not opt out into stakeholders will eventually get benefits no greater than those payable on earnings of £10,000, even though their contributions will be higher.

But all this was before last year’s pensioner revolt. Defeated on pensions at Labour’s party conference, Gordon Brown, the chancellor, announced a big increase in the means-tested Minimum Income

Guarantee (MIG) for poor pensioners, which is met by topping up the basic state pension. The MIG had been set at £75 a week in 1999, but by 2003 it will rise to £100 for single pensioners. By then it will be linked to a new "pension credit" which will allow poorer pensioners to retain more of their incomes from savings and private pensions. Crucially, future levels of both the MIG and the pension savings credit will be linked to earnings, so they will become more and more valuable in relation to the basic state pension.

The overall effect of all these changes is to make it less worthwhile for the target group of people on modest incomes to invest in stakeholder pensions. Even at last year's MIG levels of just over £78 a week for single pensioners, the commitment to uprate it in line with earnings meant that successive generations of workers would have to save more and more in order to exceed means-tested benefits (see chart). For example, a 23-year-old woman entering the workforce this year, who works full-time until she is 65 apart from a five-year break to have children, would need to build up savings of £100,000 in today's money by the time she retires to give herself an income higher than that which she would get from the MIG and associated handouts such as housing benefit. Someone working intermittently would need to accumulate even more.



"On earnings that won't grow beyond £15,000 in today's money, it's probably not worth taking out a stakeholder pension," says Deborah Cooper, a member of a recent Institute of Actuaries task force on pensions. Tom Ross, chairman of the independent Pension Provision Group, which advises the government about pensions, concurs with this view. He says that the target group of low-to-moderate earners, particularly those earning between £10,000 and £15,000 a year, now face "the most horrendous savings choices, ones that are far more difficult than for the better-off."

The difficulty in making sensible choices boils down to political risk. Will future governments offer an earnings-linked safety net through the MIG? How long will the pension credit last? Although pension savings are the longest-term commitment that people make, governments cannot keep their hands off the arrangements for public provision. This makes it virtually impossible for those on lowish incomes to plan ahead. For many, the sensible choice will be to put any spare savings in an ISA, where they will build up free of tax and, unlike a pension, can be drawn upon when they like.

If the government has made stakeholder pensions so unattractive that people do not take them up voluntarily, it may decide to make them compulsory. Mr Blake says that "the extension of means-tested benefits strengthens the case for compulsion." Shaun Crawford of Cap Gemini Ernst & Young, a management consultancy, says stakeholder pensions "will not be taken up in any large numbers until compulsion is imposed".

The government came close to making stakeholder pensions compulsory in 1998—so much so that the green paper included a reference to "compulsory funded pensions for those earning over £9,000 a year". What was once an embarrassing slip is likely to become policy in the second term.

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Gambling

Faites vos jeux

Apr 5th 2001
From The Economist print edition

It's hard to gamble in Britain, but take heart: liberalisation is on its way

IF YOU hit the jackpot on a slot machine in a British casino, your pockets will suffer. The law requires that the jackpot, which cannot be more than £1,000, has to be paid out by the machine. Spewing out that many coins takes nearly eight minutes. That may be entertaining for the punters, but the casinos complain that their floors have to be specially strengthened to take the weight of the machines. When fully loaded, they can weigh 300lb.

We want a single regulatory body

Though 94% of its population enjoy the occasional flutter on the national lottery, Britain's gambling industry, worth £42 billion a year ($59 billion), is surrounded by an extraordinary thicket of antediluvian legislation. Under the 1968 Gaming Act, casinos are forbidden to promote themselves, advertise, extend credit, stage live entertainment or provide drinks at the table. They are also obliged to impose a 24-hour "cooling off" period on new members before they are allowed to play. Only ten slot machines are allowed in each casino—perhaps just as well in view of their weight, but hardly competitive with Las Vegas.

No fun, please, we're British
European gambling restrictions

	Permitted	Banned or restricted
Advertising of casinos	Denmark, France, Germany, Greece, Italy, Netherlands, Spain	Belgium, Britain, Poland
Entertainment in casinos	Belgium, Denmark, France, Germany, Greece, Italy, Netherlands, Poland, Spain	Britain

Source: Labrokes Casinos

Not before time, this legislative farrago is about to be swept away. For the past ten months, a Home Office review body, headed by Sir Alan Budd, a former chief economic adviser to the Treasury, has been looking at the industry. After reviewing more than 200 submissions from all the key players, it has concluded that in an age of online gambling and offshore betting, the laws regulating gambling in Britain are nonsense. Although the committee has yet to finalise its report, which is not due to be published for some weeks, informed sources say its members are set on fundamental reform.

The committee will recommend that a single regulatory board should regulate all gaming in Britain. At present, a wide variety of bodies do so. Casinos, bingo clubs and local-authority lotteries are regulated by the Gaming Board. The National Lottery is run by the National Lottery Commission. Horseracing is in the hands of the Jockey Club and the British Horseracing Board, while the growing spread-betting industry is controlled by the Financial Services Authority.

One of the first tasks of the single unified body would be to produce a coherent regulatory framework for the industry. The National Lottery, for example, is allowed to advertise freely, but casinos are restricted to the classified columns. Similarly, betting shops are not allowed to be open for business on winter evenings, but there is no such ban on bingo clubs.

The committee is not likely to face much resistance to its calls for reform. Ministers acknowledge that current regulation is overbureaucratic and uncompetitive. The chancellor has already moved to reform betting tax in his budget because of the problems caused by bookmakers moving their operations offshore. Public attitudes have also changed. A study carried out for the leisure industry by KPMG, an accountancy firm, found that 89% of Britain's adults had taken part in some form of gambling over the

past year. Of the 22 types of gambling covered in the survey, 20 were considered socially acceptable by a majority. The two they didn't like were inland amusement arcades and fruit machines in cafés. Even the National Audit Office, in its report on the Gaming Board last year, noted that the gaming industry was over-regulated and could benefit from "a lighter touch".

Fundamental reform, however, will require primary legislation that will take at least a year. Some members of the Home Office review committee, moreover, are wary of going too fast. In the early 1960s, ill-considered legislation led to the establishment of more than 1,200 gaming clubs, many of which were rapidly infiltrated by criminal gangs. That led to the 1968 Gaming Act, which cleaned up the industry but put it in a straightjacket. Casinos will still need tough licensing procedures: since they provide an opportunity for money-laundering, tough identity and accounting checks are essential if criminals are to be kept out.

Penny Cobham, chairman of the British Casino Association, says that consumers should be allowed to choose how they spend their leisure time. It is hard to disagree. A liberalised, more coherent gambling regime will not turn London, or for that matter Blackpool, into Las Vegas. But it will, at least, address one of the more nonsensical areas of British life.

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London's skyline

The Canaletto effect

Apr 5th 2001
From The Economist print edition

Economic needs, architectural talent and a favourable political climate are combining to transform London's skyline

ST PAUL'S cathedral has been an architectural symbol of London for centuries. But Sir Christopher Wren's dome will soon be rivalled by a skyscraper designed by Norman Foster, nicknamed the "erotic gherkin" for its curvaceous form. And the gherkin is not alone: architects and developers are planning a flotilla of new skyscrapers to strain necks across the capital.

NewsCast

Piano's spire

Last week Southwark council received a planning application for a spire-shaped tower that would, at 306m, be the tallest building in Europe—twice the height of London's giant Ferris wheel. The London Bridge Tower, designed by Renzo Piano, an Italian architect, would contain offices, a hotel, apartments and public viewing galleries. Judging from the experience of other proposed skyscrapers, Mr Piano's tower faces a tortuous planning process. The Heron Tower (222m, including a 39m spire), proposed for the City, is to be the subject of a public inquiry. Plans for two towers in Paddington have been sent back, with a 100m height limit. But along with the gherkin (180m), these proliferating schemes suggest a new vertical ambition in the capital's property industry.

Which begs the question of why London's skyline has not been extended so far upwards before. The area's geology is less amenable to high-rise development than Manhattan's, and the need for increased office space has in the past been answered in other ways. Paul Finch, deputy chairman of the Commission for Architecture and the Built Environment, the government's new architectural watchdog, describes another of the inhibiting factors as the "Canaletto effect".

In Canaletto's famous views of London, the dome of St Paul's presides over a chorus of spires. An elaborate network of visual rules has evolved to preserve this romantic notion of London, and in particular the status of St Paul's—which became, during the blitz, an icon of national resilience. Along with views of the Tower of London, the Monument, and the Palace of Westminster, views of the cathedral from various spots along the river Thames and across London are protected. The square mile itself is a patchwork of conservation areas and listed buildings. Mr Finch wonders whether St Paul's could have been built had such stringent rules obtained in the 17th century.

In reality, of course, London's choice is not between Canaletto and Manhattan. In comparison with Paris (whose tall buildings are ghettoised in La Défense), London has evolved anarchically. Tall buildings have sprung up in some controversial locations since the war. But several of London's towers are now unloved and regretted: planners have been more inclined to tear them down than approve new ones. Many of London's residential tower blocks, designed to offer a utopian life in the sky, have been demolished in disgrace.

Yet tastes and economic circumstances are changing. Irving Yass, of London First, a business lobby for London, explains that the soaring cost of office space in the capital—now reputedly the most expensive in the world—and a string of mergers means that the need for new buildings capable of housing large workforces is pressing. The Corporation of London, which runs the City, now says it needs more tall buildings, like the gherkin and Heron Tower, if the City is to preserve its status as a global financial hub. Space is less constrained in Frankfurt, and indeed at Canary Wharf in the east of London,

Foster's gherkin

the site of Britain's current tallest building and two more towers that are nearing completion. Last week the London Stock Exchange intimated that it might relocate to Canary Wharf, following the bankers and lawyers who have already migrated.

Rivalry among different parts of London, and impatience for new buildings, also drove the construction boom in London after the Great Fire of 1666. Now, as then, an especially talented crop of architects have turned their attentions to London's skyline. Along with the gherkin, Lord Foster is responsible for one of the new Canary Wharf towers and another one mooted for Elephant and Castle, a run-down neighbourhood in south London. Richard Rogers, Britain's high priest of urban regeneration, designed one of the Paddington towers. Like Mr Piano's, their schemes strive to be environmentally friendly. Politically as well as aesthetically, the time is right for skyscrapers: Ken Livingstone, London's mayor, is broadly supportive, and was disappointed by the government's decision to hold up Heron Tower.

Sceptics argue that London has no need to take part in vulgar international height competitions, of the kind that Chicago and Kuala Lumpur are engaged in. To some, there is still something fundamentally un-British about the hubris of skyscrapers. The motives for building them are undeniably mixed: Mr Finch points out that they tend to excite only male architects, and Mr Piano accepts that some are phallic symbols of arrogance and power. But in areas such as Southwark and Elephant and Castle they would also symbolise confidence and regeneration.

London's best views need to be protected, but they can evolve. If a recession doesn't intervene, the gherkin may herald the final demise of the Canaletto effect.

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Sports stadiums

Injury time

Apr 5th 2001
From The Economist print edition

An obsession with football and a failure of political will may deprive Britain of the chance of getting a decent national stadium

IT IS Monday night at Wembley stadium. The floodlights are on. The roar of thousands of football fans fills the air. At the side of the pitch, the rival managers leap off the bench, as one team heads for goal. The excitement is...negligible, because this is just a film, and apart from a couple of hundred extras making as much noise as possible, the vast stadium is deserted.

Nice design for the new Wembley, but it may never happen

Wembley has been closed to sporting events since last November and is literally rotting away. A new stadium, which would cost £660m to build, has been designed by Lord Foster, but, after five years of false starts, the chances of it ever being built still look remote. Its fate is intimately tied up with that of an athletics stadium planned at Pickett's Lock in north-east London, which also seems to be going nowhere. London is due to host the World Athletics Championships in 2005, but if work on the Pickett's Lock stadium does not start soon, those games will simply go elsewhere for the lack of a venue.

So how did things come to such a pass? According to a report published this week by the House of Commons select committee on media, culture and sport, the mess can be blamed either on political failure—there's nobody pushing to get this done—or on British cultural limitations—you can't get anybody interested in anything except football.

The saga began in 1996 when the Sports Council decided that, with the first National Lottery grants for capital projects being handed out, the time had finally come to build a new national stadium for football, athletics and rugby league. The Sports Council looked at 34 sites and chose Wembley, mainly for its transport connections, but also because a stadium in London would have a better chance of getting big international events like the World Cup or the World Athletics Championships (WAC).

The Wembley site, including the crumbling old 1923 stadium, was bought for £106m of lottery money in 1999. The project's proponents realised that only football (in particular, FA cup and England international matches) would make it pay, so football took the lead in the development. A wholly-owned subsidiary of the Football Association, Wembley National Stadium Limited (WNSL), was formed to manage it.

But the other sports refused to accept the FA's control of the project. The British Olympic Association claimed that the design wouldn't do for the Olympics. The athletics people said it was too big: except during the Olympics, they would not be able to fill it. The idea of a separate £20m platform for athletics was rejected as too expensive.

In December 1999, the culture secretary, Chris Smith, tried to resolve the problem by hiving off athletics to a new £60m stadium at Pickett's Lock. This was to be funded partly by £20m from the lottery money originally earmarked for Wembley; Wembley would therefore become not a stadium for athletics, rugby and football (which was what it got the lottery money for in the first place) but a football and rugby stadium.

The transfer of the £20m to Pickett's Lock solved one problem but caused another. WNSL got short shrift in the City when it tried to raise £400m at the end of last year. It reckons that investors were concerned that the government no longer viewed the new Wembley as a national sports stadium. It will try again soon; but these days investors are gloomier than they were then.

The Pickett's Lock project, meanwhile, has not yet solved the question of how a sport that attracts so few spectators and so little money can make a new stadium pay. Sport England, which manages the lottery money, has refused to commit itself to funding the project unless a suitable business plan is presented which covers its running costs.

It may well be that neither project goes ahead, and that Britain is left without an arena that could stage the Olympics or any other grand sporting event. Britain's obsession with football aside, the Wembley and Pickett's Lock projects have been blighted by a lack of co-ordination between the various sports bodies, and between those bodies and the government. The select committee reckons that a Minister for Events is needed to bang heads together.

Other countries which have recently staged big, successful sporting events have taken a different approach, devolving responsibility to cities such as Sydney, Melbourne and Barcelona. Thanks to the government's constitutional reforms, London now has a mayor who could take charge of such a project. No doubt Tony Blair would relish giving Ken Livingstone, the mayor of London, the power and prestige that would go with building a national stadium to win Britain the next Olympics.

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Bagehot

The majority doesn't matter

Apr 5th 2001
From The Economist print edition

HOWEVER thrilling it is when your dentist cancels an appointment, the high seldom lasts. At some point, a bad tooth needs attention. By the same token, Tony Blair's decision to seek re-election on June 7th instead of May 3rd brought the briefest of reprieves to William Hague. A week is a long time in politics, but not even an extra four of them will give the Conservative leader long enough to climb the Himalaya of adverse opinion polls and topple Labour in a general election. Having faced certain defeat in May, Mr Hague now faces certain defeat in June. At best, he can hope to make a bigger dent than was otherwise expected in Labour's parliamentary majority if he performs conspicuously well during the foot-and-mouth crisis, or if the prime minister performs conspicuously badly. But even that is not certain. On one reading of the opinion polls, Mr Blair stands to do better still now that he has shown a proper feeling for the plight of farmers by adjusting the election timetable. No wonder the Tories accepted with such bad grace the reprieve for which they had themselves been arguing. May or June, this is not an election they expect to enjoy.

A general election whose outcome is a foregone conclusion is not likely to be a bundle of laughs for voters either. They can stave off boredom by betting on the size of Mr Blair's majority. But in a winner-takes-all democracy, does the size matter, provided it is big enough not to be whittled away by death, defections and by-elections?

During 1983's election, Francis Pym, Margaret Thatcher's foreign secretary, mused on air that "landslides don't on the whole produce successful governments." A furious Mrs Thatcher thought otherwise: soon after obtaining a landslide, she obtained a new foreign secretary. But Mr Pym was on to something. Even some Labour MPs have been known to whisper that the sheer size of Mr Blair's 179-seat majority has allowed him to treat Parliament with an arrogant disdain. With sheep-like Labour bottoms planted on 419 of its 659 seats, the prime minister has little fear of embarrassment in the House of Commons, which is supposed to hold him to account.

Would a smaller majority change this? In theory, a smaller majority makes a government more vulnerable, and so makes its own MPs even less likely to rock the boat. But in another theory, a smaller majority gives would-be rebels real hope of changing government policy, and so makes them more likely to rock it. Philip Cowley, a political scientist at Hull University who has studied the link between the size of majorities and the behaviour of backbenchers, says that everything depends on the context. In 1992 John Major scraped to victory with his Conservative majority reduced from 101 to 21. You might have expected their imminent hanging to concentrate Tory minds on unity. Instead, Mr Major's own Eurosceptic "bastards" (his word) made his life a misery.

The defect of the analogy is that nobody expects Mr Blair's majority to shrink to the size of Mr Major's. The bookies now reckon that Labour will return with more than 370 seats. So if its backbenchers become more rebellious, it will not be because the majority looks more vulnerable, but for other reasons.

One such is that they will have grown in confidence. A landslide sweeps into Parliament many people who never really expected to become MPs at all. The 1997 election caused the biggest changeover of MPs since 1945. Grateful and confused, these newcomers were happy during Mr Blair's first term to provide obedient lobby fodder. By his second, they may have formed an opinion or two of their own. Quite a few, moreover, will at last have realised that they are not destined for promotion under Mr Blair, no matter how servile their behaviour. A prime minister's powers of patronage are impressive: he can make 80 or

so MPs into ministers and another 40 or so into parliamentary private secretaries. But a big majority means that many more are being robbed of ambition precisely when they are growing in confidence. Given the right leader or the right cause, they just might coalesce into a danger. But this is a long-shot, and has little to do with the size of the majority.

Arguably, the size of Labour's majority will have a bigger impact on the opposition parties. Some Labour ministers hope for a modest win because the Conservative Party would then be likelier to keep the unelectable (they presume) Mr Hague as leader. But Mr Hague's fate is not simply a product of electoral arithmetic. Although the tearoom's gossips reckon that winning back about 50 of the seats the Tories lost in 1997 should keep him safe, there is, in truth, no precise number. What is really happening is that the gossips who want Mr Hague to remain party leader are playing a game of expectations-management against the gossips who want to replace him. The latter inflate the number of seats Mr Hague must gain, and the former talk the number down. Besides, there is no obvious replacement: the familiar big beasts in Conservatism's jungle are either retiring (Michael Heseltine) or too fond of Europe (Ken Clarke) to appeal to today's Tories. Even her admirers admit that the admirable Ann Widdecombe comes over as a trifle batty; and even his accept that Michael Portillo's recent odyssey of reinvention and self-discovery has left party stalwarts cold. The Tories may keep Mr Hague no matter how big Labour's win.

What of the Liberal Democrats? Surely a reduced Labour majority would make it easier for Mr Blair to persuade his party of the need for some sort of "progressive" coalition with the third party, even if that required giving Britain the proportional electoral system the Lib Dems crave? The trouble is that the very circumstances that would cut Labour's majority—a healthy swing to the Tories—would also scythe down the Lib Dems in Parliament, and so reduce their value as partners. No matter how you look at it, Britain is set for a election whose outcome is already certain, in which the size of the majority scarcely matters. See you at the dentist.

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Railtrack

End of the line?

Apr 5th 2001
From The Economist print edition

Long reviled for looking after shareholders at the expense of passengers, Railtrack has failed its shareholders too

THERE are plenty of reasons why everybody hates Railtrack—with frequent, photogenic train crashes and massive disruption to the rail network at the top of the list—but there is one overriding reason for the hostility. People believe that because the rail network has been privatised, the company that operates the tracks looks after its shareholders at the expense of the passengers. This week Railtrack showed them just how wrong they are. With the stock price tanking, even the shareholders have been screwed.

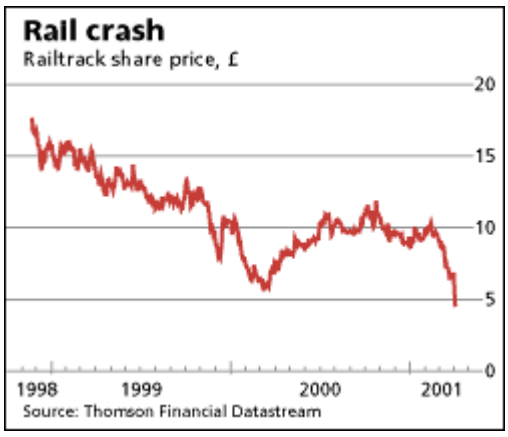
Railtrack's lost the Chunnel link

Investors who piled into the under-priced privatisation in 1996 at £3.90 were in for an exhilarating ride as the price rose to a peak of £17.68 in November 1998. They reckoned they had bought into a (then) loosely-regulated monopoly with no discernible problems and a growing income as passenger traffic rose healthily and the privatised train operating companies (TOCs) applied private-sector marketing to boost their revenues, and indirectly those of Railtrack. Since those heady days, the price has fallen by nearly three-quarters, with much of that decline over the past week. Why?

On April 2nd, the government announced that it would come up with £1.5 billion in advance subsidy to Railtrack for sustaining the network. That did not reassure investors. The injection was expected, and some other discouraging bits of news came out at the same time, which sent the share price tumbling.

The company was denied its biggest growth opportunity. Some years ago, when the company building the Channel Tunnel Rail Link (CTRL) got into difficulty, the government did a deal with Railtrack to buy the new line from the troubled developers. In return, Railtrack would get the subsidy that went with running this "socially desirable" line, and could look forward to growth in revenues from it.

The deputy prime minister, John Prescott, made it clear on April 2nd that Railtrack would not get the CTRL, because of its past failings. The project would be handed over to Bechtel, an American construction and project-management company that played a big part in rescuing the Channel Tunnel. Bechtel is also likely to be the developer for the upgrade of the East Coast main line, depriving Railtrack of another opportunity to make a risky investment and earn a good return if it does the job well.



The only other remaining growth opportunity is Railtrack's partnership with Virgin Rail in the upgrade of the West Coast mainline. Estimates for the cost of this had already tripled to £6.3 billion, but now it emerges that the bill will rise by another £500m. Adding to these woes, the government has decided to appoint a public-interest director to the board of Railtrack, and the bill for compensation to train operating companies (TOCs) for the disruption caused by the post-Hatfield repairs could well reach £3 billion. The original estimate was £500m. TOCs may find they can sue for damages over and above the automatic penalties written into their contracts with Railtrack.

Railtrack is now no longer a monopoly provider of rail infrastructure, and has also lost out on opportunities to earn unregulated profits on new ventures. That leaves it as a sort of municipal gasworks

with nowhere to go. “It’s on a vicious downward spiral,” says Chris Tarry, transport analyst at Commerzbank in the City. Given that investment analysts hate to write off stocks, this is telling stuff. Some sort of break-up is getting closer.

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Elected mayors

Borderline case

Apr 5th 2001 | BERWICK-UPON-TWEED
From The Economist print edition

ONCE London had elected its mayor, the government had hoped that other big English cities would follow suit—though preferably, it thought, electing somebody more pliant than Ken Livingstone. This was part of the plan to revive both the efficiency of, and voters' interest in, local councils. But few cities have shown much interest in having an elected mayor. And, rather embarrassingly for Tony Blair, the first place to hold a referendum on the idea looks like being the tiny borough of Berwick-upon-Tweed.

This town of about 12,500 people, a mile or so south of the border between Scotland and England, has a long history of being awkward. Between 1147 and 1482, Berwick was a pawn in the power game between the Scottish and English monarchs and changed hands 13 times. These days, the town is definitely in England, although its football team, Berwick Rangers, plays in the Scottish league.

Throughout this turbulence, at least the post of mayor survived. In 1551, the mayor presided over what Edward IV and Mary Queen of Scots declared to be a "free state" between the two kingdoms. But the present council is a pale shadow of past grandeur. Northumberland County Council handles education and social services, leaving the borough with housing, planning and parks. The mayor, Graham Exley, who was elected by the 29 councillors on Berwick Borough Council, does little except open fetes.

Brian Douglas, a councillor, who styles himself a New Labour Liberal independent, thinks it is time for the mayor to be directly elected. He says surveys have shown lots of voters are dissatisfied with the council. Even the staff seem unhappy; the 158 council employees last year passed a vote of no confidence in the chief executive. He quit soon afterwards and has not yet been replaced.

Mr Douglas says he found no difficulty in securing the 1,100 signatures required by law (5% of the electorate) to force the council into holding a mayoral referendum. This is odd, since a slim majority of the 10% of voters who answered a council questionnaire just wanted a better committee system. Bill Ferguson, the Liberal Democrat who leads the council, reckons that will be the outcome of the referendum too, and grumbles that it is a waste of money. Even holding it on June 7th, the same day as the expected general and local elections, will cost £25,000, he says.

What both sides agree on is that Berwick, the most northerly bit of England, seems pretty peripheral to the thinking of London politicians and is suffering as a result. Three years ago, a knitwear factory closed with the loss of 480 jobs, and the town still feels the pinch. Berwick's councillors, with just £3.5m a year to spend, look enviously at the more lavish funding their counterparts get across the border. Mr Ferguson reckons the Scottish Borders council spends about £800 a year more on each of its people than do the Northumberland councils. Mr Douglas thinks an elected mayor might make southern politicians pay more attention.

Perhaps the referendum Berwick really ought to be organising is on making one more shift of allegiance, back to Scotland. That would give King Tony a headache.

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We're in fashion

Apr 5th 2001
From The Economist print edition

RUMOURS that Stella McCartney, a fashion designer and member of the popocracy, might be about to leave the Paris fashion house Chloé for Gucci covered an astonishing amount of newsprint this week. But there is more to the current British obsession with fashion designers than a desperate desire to read (and indeed write) about something other than barbecued beef carcasses. Britain is doing rather well at fashion at the moment.

High fashion used to be something best left to effete foreigners on the other side of the Channel, but not any more. If Ms McCartney does go to Gucci to set up her own label, she will be joining forces with another successful expat, the designer Alexander McQueen. They are amongst several British designers who have been poached by the big Italian and French fashion houses in recent years. Julien Macdonald is at Givenchy, and John Galliano is at Dior.

And there are plenty more where they came from. Amongst the young stars who have already made their name in Britain and who could move abroad are Robert Carey-Williams, Eley Kishimoto and Hussein Chalayan, who last year won his second British designer of the year award at London's Fashion Week. And the older generation of London-based designers, such as Paul Smith and Vivienne Westwood, are still going strong.

Everyone has tried to claim some credit for this success story, and the fact that Mr Chalayan was presented with his award in front of Cherie Blair and the famously fashionable Pauline Prescott, respectively the wives of the prime minister and deputy prime minister, tells it own tale. But just why have British designers done so well in recent years?

Maybe, perversely, because Britain has been so hopeless at fashion in the past. Since the British never did clothes very well, today's designers are not constrained by ideas of how things should be done. Perhaps the absence of a strong stylistic tradition, married with a national weakness for eccentricity, allows British designers a freedom that their continental counterparts lack.

That is what Wendy Dagworthy, now at the Royal College of Art but once Stella McCartney's teacher at Central Saint Martins College of Art and Design in London, thinks. Whereas French and Italian fashion students labour under the deadweight of tradition and past glory, she says, British students are encouraged to be individualistic. The result is that there is no generic "British style", but many talented designers who have the self-confidence to develop their own style. This is what attracts the continental fashion houses that have to lead on the catwalk to stay ahead of the competition.

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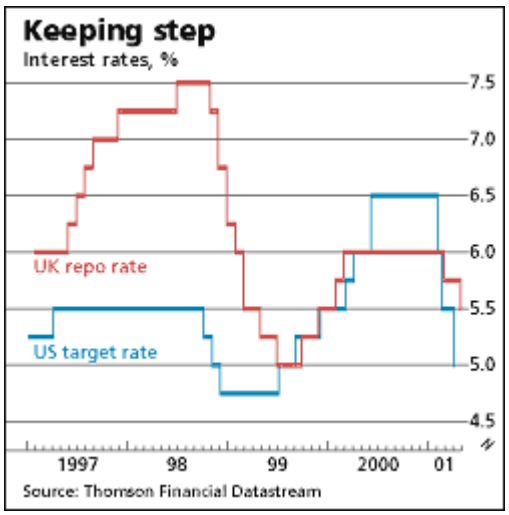
Interest rates

The Bank cuts again

Apr 5th 2001
From The Economist print edition

THE Bank of England, as expected, cut interest rates by another quarter point on April 5th, lowering the base rate to 5.5%. The Bank cited “downside risks” to economic activity in Britain from the global slowdown, recent falls in equity markets and foot-and-mouth disease.

If there was any doubt in the Bank’s Monetary Policy Committee (MPC) about whether to cut rates, two “early warning” business surveys probably settled the matter. The purchasing managers’ index (PMI) for manufacturing reported a sharp fall in new orders in March compared with February. The overall index also fell abruptly to a level indicating a contraction in activity. The survey suggested that “UK manufacturing is joining the global downturn”, said Michael Saunders, economist at Schroder Salomon Smith Barney. Hard on its heels came another PMI for services heralding slower growth in a sector that has underpinned the economic recovery for several years.



Since the MPC last met, there has also been a sharp fall in the London stock market. The FTSE-100 index has fallen by almost a tenth since the March meeting and is down by about a fifth since its most recent peak last September. The increasing importance of equities in household wealth means that such a decline is likely to temper the rapid growth in consumer expenditure that has been worrying the Bank.

The MPC will also have been aware that inflation could fall below 1.5% this spring. This will trigger a letter from the Bank’s governor to explain why inflation has deviated by more than 1 percentage point from the 2.5% target—and what the MPC is proposing to do about it. Sir Edward George can readily point to the effect of Gordon Brown’s last budget, which will clip the annual inflation rate by half a percentage point in March and April, according to official statisticians. However, a new measure of core “persistent” inflation recently published by the Bank suggests that underlying inflation was just 1.2% in February.

The Bank also seized the political window of opportunity to cut rates. Although the MPC is independent, it does not want to get caught in electioneering crossfire. Tony Blair’s decision to abandon a general election on May 3rd meant that this week was no longer an electorally sensitive moment to cut rates. If it happens, as expected, on June 7th, the Bank’s next politically neutral moment to cut rates is not until July.

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Dark shadows over Israel and Palestine

Apr 5th 2001 | JERUSALEM
From The Economist print edition

AP

But after a week of intense violence, the Israelis and Palestinians start talking

SIX months into the al-Aqsa *intifada*, and one month into Ariel Sharon's administration, the violence between Israel and the Palestinians is spiralling dangerously. But on Israel's uneasy streets a teeth-gritting public mood seems to endorse the government's bleak forecast that many more casualties have yet to be inflicted and sustained.

Events over the past ten days have been particularly threatening. Gaza has been twice bombarded by helicopter gunships firing missiles at buildings belonging to Force 17, an elite Palestinian unit that Israel says is involved in terrorism. The attacks were in response to the killing of two boys by a suicide-bomber and to a mortar attack on a settlement. On April 2nd, Israeli tanks shelled Bethlehem after a sniper killed an Israeli soldier guarding a Jewish holy site. The same day, Israel restarted the policy of assassination that had fallen briefly into disuse after Ehud Barak left office: a member of Islamic Jihad in Gaza was killed in his truck by helicopter-fired precision missiles. His organisation vowed revenge, but Israel said there would be more such killings.

Mr Sharon went beyond the punishments set by Mr Barak when, on March 31st, he sent soldiers into a Palestinian-controlled village to abduct half a dozen men (three of whom have since been returned). The army said it would not be bound by any lines on the map when striking at terrorists. But the prime minister has, so far, stopped short of permanently reoccupying any Palestinian-controlled land—a step that would destroy whatever is left of the Oslo infrastructure.

He is resisting pressure from his far-right supporters to seize a Palestinian-controlled hill in Hebron, from where a sniper killed a baby girl in a Jewish enclave last week. Settlers in Hebron, together with other Jewish militants, have been attacking Arab homes and shops in the city in an effort to provoke more firefights with the Palestinians, and thus force the army's hand.

For their part, the Palestinians have sharply increased the number of bomb attempts inside Israel. Several have gone awry, and the ones that have exploded have resulted in relatively few deaths. But more are threatened. In the West Bank and Gaza, ambushes and shooting have steeply increased. Palestinian gunmen armed with telescopic sights—a leaf, this, from Israel's book—have been taking a rising toll of soldiers. Israeli deaths since the *intifada* broke out last September now stand at 72, of which 31 were soldiers. A far cry from the Palestinian figure of nearly 400—in the past week alone eight Palestinians have been killed—but no longer an insubstantial number.

Laid up at his farm with flu this week, Mr Sharon is discovering the hard way that there is no quick fix, and certainly no military fix, to violence. But the Israeli public seems stoical, and though Mr Sharon is patently unable to keep his election promise to restore security, he faces little criticism. The unity government turns out to be more than just a marriage of political convenience: it reflects an atmosphere of broad consensus, born of the view that Mr Barak offered the Palestinians the most generous possible

deal, only to have it thrown back in Israel's face.

Yasser Arafat is held personally to blame not only for what is perceived as a historic missed opportunity, but also for the escalating violence. Military sources argue anonymously in the press over whether Mr Arafat explicitly orders specific acts of terrorism, or merely condones the violence in general. Many Israelis, including many peaceniks, now say they have given up on Mr Arafat, and that peace will have to wait for a new generation of Palestinian leaders.

Reuters

A glimmer of hope from Athens

Shimon Peres, Israel's foreign minister, still refers to Mr Arafat as a peace partner, albeit one "who has seriously erred". On April 4th he talked to two senior Palestinians, Nabil Shaath and Saeb Erekat, on the fringes of a conference run by *The Economist* in Athens. Later that day, the security chiefs on both sides met in Israel, an encounter marred when the Palestinians were fired on as they returned to Gaza. Other, more secretive, contacts, including a meeting between Mr Arafat and Mr Sharon's son, Omri, have upset right-wingers who fear that the prime minister might be rethinking his pledge to resist talks so long as the violence continues.

It was this pledge that has helped to prolong and intensify the violence. The Palestinians themselves are uncertain how far Mr Arafat remains in control of the uprising, either directly through his security forces and the Fatah movement, or indirectly through the latitude he has granted the bombers of Hamas and Islamic Jihad. What has become clear, however, is that he is not doing anything to prevent violent action. So long as Mr Sharon offers nothing in return for calling a halt, it would be a surrender that Mr Arafat is neither able nor willing to accept.

The Palestinian leader has expressed readiness to discuss a joint Egyptian and Jordanian proposal, which was raised by Hosni Mubarak in his meeting with George Bush in Washington on April 2nd. The proposal amounts to a package of reciprocal measures. Israel would lift its siege of Palestinian areas, and the Palestinian security forces would resume co-operation with their Israeli counterparts. Political negotiations would then resume, both on permanent-settlement issues and on outstanding "interim agreements" such as Israel's promised but long-forgotten third West Bank redeployment. The Palestinians also insist that any return to talks must be accompanied by a freeze on Israeli settlement building.

Mr Sharon would have none of that. The Egyptian-Jordanian plan, he said on April 1st, was no more than a ruse to get Israel to negotiate "under fire". The most he says he will consider, after the Palestinians have ended their violence, is a non-belligerency agreement based on long-term interim arrangements. But after seven years of tortuous negotiations, say the Palestinians, so limited an accord is simply not on.

Mr Sharon may be hoping that Mr Arafat will draw back from the brink as he faces Israel's slow but deliberate destruction of his Palestinian Authority. But this, says a Palestinian analyst, Khalil Shikaki, "is an extremely dangerous assumption. If the choice is between preserving the Palestinian Authority and remaining legitimate in the eyes of his people, Arafat will choose the latter."

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Zimbabwe

Biking the samizdat

Apr 5th 2001 | HARARE
From The Economist print edition

AS THE opposition struggles, without success, to make its mark on Robert Mugabe's regime, donor countries have switched the address on their aid packets. Frustrated by the government's non-accountability, corruption and economic mismanagement, most foreign governments have stopped giving aid to Mr Mugabe's men. Instead, they are channelling money to non-governmental organisations that promise to promote democracy and the free flow of information.

France stands out as an exception. Unlike other European governments, the French are still trying to cultivate good relations with Mr Mugabe. Last month, he was given red-carpet treatment when he met Jacques Chirac, France's president in Paris. And last week Zimbabwe's fuel crisis eased slightly thanks to a shipment of French fuel. By contrast, Britain has severely cut back its direct bilateral aid, and pulled out a military training team that had been operating in Zimbabwe since 1980.

The opposition party, the Movement for Democratic Change (MDC), and other groups continue to try to bring about peaceful reform. Last week saw the launching of a fresh campaign to draft a new constitution, backed by a coalition of more than 85 NGOs. These included trade unions, women's organisations, gay-rights groups and churches. The activists made no bones about their foreign backing. "At least we didn't steal the money," said the meeting's chairman, to laughter from participants all too aware of the government's reputation.

Another, more original, foreign-backed project is a bid to get independent news to Zimbabwe's rural areas, which are currently dependent on government propaganda reproduced in the state-owned newspapers and radio. From this week on, an independent daily newsletter, the *Daily Bulletin*, is to be produced in Harare, and then sent by e-mail to six rural sites where it is printed. Copies are then carried to the surrounding villages by young men on mountain bikes.

The project is fraught with danger. Those taking part are bound to be attacked by Mr Mugabe's "war veterans", who have already banned independent newspapers in many rural areas, and have beaten, and sometimes killed, opposition supporters. Those caught delivering, or even reading, the newsletter are at risk. The bike riders have been given digital cameras to record any violence they may encounter, but the high-tech equipment will offer little protection against the blows of Mr Mugabe's thugs.

The computers, cameras and mountain bikes were all bought with aid money, including contributions from British and American NGOs. The government, naturally, is furious about this shift in aid. The drive for a new constitution has been dismissed as "bogus" by Jonathan Moyo, Mr Mugabe's increasingly powerful information minister, because it is backed by foreigners. And this week the government rushed a bill through parliament to make all foreign support to political parties illegal.

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A Tuscan village in South Africa

Apr 5th 2001 | JOHANNESBURG
From The Economist print edition

NESTLING between concrete highways, with shopping malls to the south and a squatter camp to the north, a medieval Tuscan village has popped up in Johannesburg. If the mark of an authentic casino is fakery, then Montecasino is authentic. Fake pigeons perch on fake parapets on fake old Italian houses. Phoney ducks frolic in pseudo-streams that babble beside imitation cobbled streets. Beneath the bogus Tuscan sky, 1,700 slot machines flash, honk and chatter.

Gambling is booming in South Africa. In every large city, casinos are opening. Forty have been licensed; more than half are complete. Most aim for Las Vegas-style razzle-dazzle. Caesar's, also in Johannesburg, boasts faux-classical statues and a restaurant on an ancient Egyptian barge. Hemingway's, now being built in East London, promises an experience that will bring back the great man's novels. Pawn your watch at the shop outside, leave your gun at the door, and you are ready to lose money in an entertaining way.

Under apartheid, South Africa's Calvinist rulers frowned on casinos, and they were banned. But there was a loophole: small patches of land had been declared "independent" homelands, so that the government could dump unwanted black people there. Since South African law did not apply in these homelands, whites flocked there to play roulette, watch strip shows and fornicate across the colour line.

With democracy came legalisation. This hurt the estimated 2,000 illegal casinos, which were often tiny, sleazy dives. It hurt the homeland casinos, too, because their new, legal rivals were built closer to cities. Some people worry that it is now too easy for South Africans to gamble.

The welfare minister, Zola Skweyiya, called last week for a review of gambling policy. A study by the Human Sciences Research Council, a think-tank, found that poor punters were losing more than they could afford, and that one gambler in seven borrowed to bet. It lamented the presence of cash machines in casinos, where long queues form at midnight, as customers wait to withdraw the next day's ration of cash. A local journalist observes that the slot-machine addicts at Caesar's look so anaesthetised that "one could quietly have harvested a bucket-full of organs without being spotted, though I would have steered well clear of the livers."

The official line is that gambling is better legal. Politicians believe, probably correctly, that they will spend the windfall from licence fees and casino taxes more benevolently than gangsters would. Gambling supplied 14% of provincial-government revenues last year. A national lottery, which began last year, rakes in about 50m rand ($6m) a week. In order to win licences, casino operators are obliged to create jobs in poor areas, to hire black subcontractors, and to offer shares in the business to politically favoured investors, such as trade unions or black-owned firms. Montecasino's operators had to build a convention centre in Johannesburg, which the government hopes will boost tourism.

South Africa is far from attracting the hordes of gambling tourists that Las Vegas does. But the new casinos are not without point. Many have cinemas, some have wildlife, and the eggs benedict at Montecasino are quite tasty, though smothered a bit too thickly in Hollandaise sauce.

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Sierra Leone

The spreading battleground

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From The Economist print edition

A chunk of West Africa is in danger of being engulfed in Sierra Leone's war

A RECENT surge of optimism suggested that Sierra Leone's painful war might at last be drawing to a close. Last month the rebel Revolutionary United Front (RUF) allowed a United Nations force, led by a tough Nigerian battalion, to move into rebel-held areas at Lunsar and Makeni, north-east of the capital, Freetown. More good news appeared to follow on April 2nd when a senior rebel commander, Gibril Massaquoi, said that the RUF wanted an end to the ten years of war, and that UN troops were welcome anywhere in rebel-held areas.

Sierra Leoneans could do with hope. Some 43,000 of them have been killed in the past ten years. Almost half of the country's population, some 2m people, have been forced to flee their homes. The north and east, including the diamond areas, are dominated by the RUF, a nihilistic movement that projects its power by murder, rape and mutilation. The rebels' ultimate controller is Liberia's Charles Taylor, who supplies them with arms in exchange for diamonds.

The rest of the country is nominally under the control of an elected president, Ahmed Tejan Kabbah. It is protected by local militias known collectively as the Civil Defence Forces, a 10,500-strong UN force, and a British guarantee that Freetown will be defended should the rebels again attack it.

But the RUF's new invitation has to be looked at closely. The UN might be welcome, but not in the name of the government in Freetown. The RUF still sees itself as boss in the region it controls; it demands that the UN should ask its permission before going anywhere in these areas. No government officials will be allowed in. Furthermore, the rebels will disarm only if the government forces do so too, and if there is a settlement in which their imprisoned leaders, including their dreaded chief, Foday Sankoh, are released from prison and given places in an interim government. A rebel mission arrived in the capital on April 4th to stress these last points. In other words, no surrender.

There has been a break from actual fighting in Sierra Leone since a ceasefire was agreed last November, though Human Rights Watch, a lobby based in New York, says the rebels' savagery towards refugees and displaced people continues. The truce is attributed to two factors: first, Liberia's Charles Taylor is facing UN sanctions for his support of the rebels; and, second, many RUF fighters have headed north to fight and loot in a new war in neighbouring Guinea. That war too is sponsored by Mr Taylor, as well as by the Guinean opposition, which employs Sierra Leonean rebels as mercenaries.

The UN, Britain and Sierra Leone's own government are working together on a three-part plan. This involves stabilising the non-rebel areas and moving into rebel-held territory; building a new army for Sierra Leone; and cutting the RUF's revenue by stopping the export of illegal diamonds through Liberia. The first part of the plan has so far had only mixed success. The UN has managed to talk and argue its way into parts of the almost empty and already-looted north. But this tactic is unlikely to work in the east, where the lucrative diamond fields lie. Indeed, by letting the RUF keep its guns and stay in control, the UN allows it to gain respectability and to present itself as a legitimate party in a political dispute.

Until a new Sierra Leonean army, now being trained by a 600-strong British unit, is ready, there is no chance of recapturing the rebel areas. The training may be completed by September, but even then the army is unlikely to have the commitment or experience to defeat the rebels. Britain has trained Sierra Leonean troops before, but their loyalty to the government has been wobbly, at best.

Mr Kabbah's government is unpopular; it is unable to deliver services, and shows general inertia. Elections were due last month but Mr Kabbah postponed them for six months, with parliament's approval. If he asks for another extension in September, he could get a refusal—and a further blow to his already weak government.

The third part of the plan—stopping the illegal diamond trade—is also in trouble. Britain has amassed substantial evidence of Mr Taylor's involvement in Sierra Leone's war, and this has been confirmed in a UN report. But when tough sanctions against Liberia were proposed at the UN Security Council last month, West African states argued that Liberia should be given two months to mend its ways. Mr Taylor was reprieved and is now busy trying to convince the world that his hands are clean. This week he sent an envoy to persuade the council that Liberia was indeed dealing with its concerns over diamond trading. Kofi Annan, the UN's secretary-general, has set up a committee to monitor progress. But many suspect that Mr Taylor could be using the two months to find better, more secretive routes for diamond-buying and gun-running.

Neighbours in danger

And spreading the war yet further. While the world concentrates on bringing peace to Sierra Leone, Mr Taylor and the RUF are part of a longer game on a bigger playing-field: an arc of West Africa that includes Guinea, and perhaps also Côte d'Ivoire and Guinea-Bissau. Last September, fighting erupted in Guinea, when dissidents launched attacks on the government's forces near the Sierra Leonean border. They were helped by Mr Taylor, and by RUF fighters who had been promised loot and cash. Recruiting illiterate, disaffected young people, giving them guns and letting them loose is an all-too-easy game in this part of West Africa.

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In praise of rules

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From The Economist print edition

EPA

Asia's companies are coming of age. To compete internationally, they must now adopt the rules of the global capital market, says Andreas Kluth

"UNTIL two years ago, no one here had heard of 'conflict of interest' or 'fiduciary duty'," says a top Chinese securities regulator. Having spent years in America studying law, he knows how the meaning of "fiduciary" has evolved over centuries of legal precedent in common-law countries such as Britain and America; but how is he supposed to explain it to his countrymen? For now, he has translated it into the Chinese characters for "principle of honesty and trust", but he still smiles when he thinks about it. "What on earth does that mean?" he asks. "Being a good person?"

Still, fiduciary duty, he continues, is a building block of good corporate governance, and good corporate governance is what companies in his country are going to have. So he has drafted a chapter of definitions, and is forcing bosses to read it. He takes the same approach with other exotic ideas such as independent board directors, auditing and remuneration committees, class-action law suits and insider trading. "Right now we're just pushing concepts into rules," he says. That may sound abstract, but some of it is only too real. His organisation punishes 700 companies a year for falling foul of the rules; the chairman of one, found to have defrauded shareholders, was executed.

In the developing countries of East Asia today, there are a few—not many—people who, like that Chinese regulator, have seen the light. The light in question is not necessarily that of democracy or individual freedom as such, at least not yet. Instead, it is that of protecting the rights of individuals and minorities in one particular area of life: business.

Sustainable economic growth requires efficient capital markets, and today these markets are global. They consist of myriad shareholders and creditors who each take small stakes in many different companies. If investors are confident that their rights are well protected, they open their wallets; if they fear that majority shareholders, managers or governments might fleece them, they hold back.

The history of capitalism is strewn with episodes of excessive enthusiasm followed by excessive caution, and East Asia has recently added another chapter. For a few years, it looked as though the entire region might vault from third world to first in a few decades. South Korea, Taiwan, Hong Kong and Singapore had, more or less, done so already, and Thailand, Malaysia and Indonesia seemed poised to follow. Mesmerised by this "Asian miracle", western investors poured their money into the region. They knew that its legal systems were immature and its companies opaque, but, as in all bubbles, greed triumphed over caution.

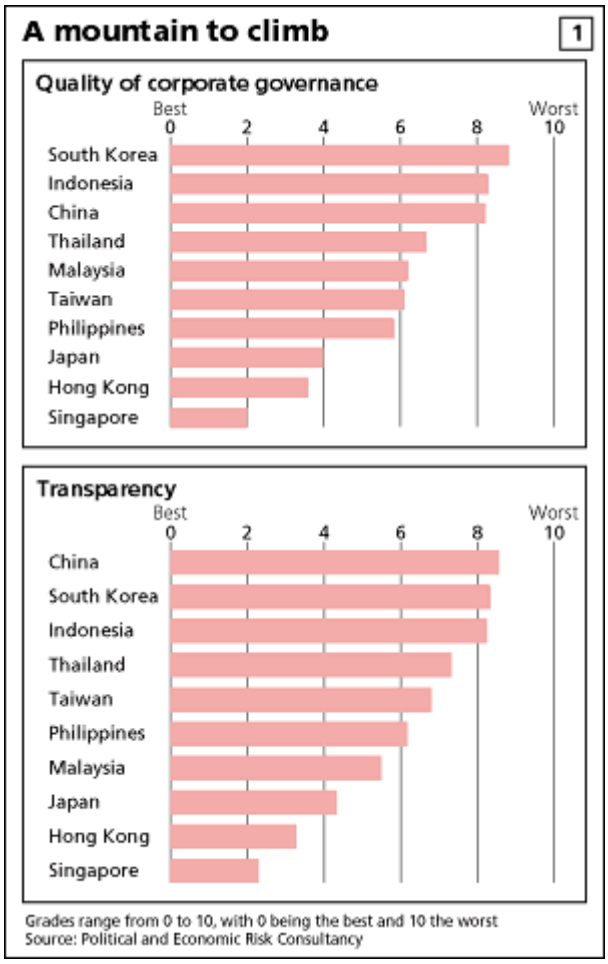
The "Asian miracle" ended in July 1997, abruptly turning into what is now known as the "Asian crisis". Investors were badly burnt, and those who could get out did so in a hurry. Suddenly the lack of transparency, of good corporate governance and of legal protection rose to the top of the agenda. A consensus evolved that, unlike previous busts in Latin America, the Asian crisis was caused mainly by mismanaged companies rather than by profligate governments. Ultimately, this came down to failures in

corporate governance. Misinvestment and overborrowing was blamed on the absence of proper checks and balances to monitor Asia's tycoons and crony capitalists.

So the International Monetary Fund (IMF) made reforms of corporate governance and related institutions a condition for its bail-outs in the region. Several of the countries hit by the crisis drew up new legislation; Thailand, for instance, passed new bankruptcy laws and corporate-governance codes. An "Asian Corporate Governance Association" was set up to re-educate tycoons, along with national institutes of directors. South Korea formed the "People's Solidarity for Participatory Democracy", a forum for shareholder activism.

But more than three years on, it is becoming clear that these talking shops have achieved little. Corporate culture in the "crisis" economies—leaving aside the offshore havens of Singapore and Hong Kong, which benefit from a colonial legacy of common-law institutions, relatively strong judiciaries, and low corruption—has barely changed at all. ING Barings, a European brokerage, recently advised global investors to keep out of Malaysia, Thailand, the Philippines and Indonesia altogether.

China is less easy to judge. On one hand, it performs badly in a number of areas that investors care about, such as corporate governance and transparency (see chart 1), as well as the legal system. PricewaterhouseCoopers, an international accounting firm, has worked out that all these factors add up to a tax on business of 46% (on top of normal government taxes), which makes doing business in China offputtingly expensive.



But China is a special case, for two reasons. First, the potential rewards are higher: China is the largest untapped market in the world. And second, investors and analysts claim to recognise in China a political will to change that is unmatched elsewhere in the region. Tony Perkins, at the Beijing office of McKinsey, a consultancy, says the main effect of the crisis in South-East Asia and South Korea may have been that it scared China into getting its priorities right. When Jiang Zemin, China's president, recently received Sandy Weill, the boss of Citigroup, an American bank, he is said to have grilled his visitor on the minutiae of corporate governance. By contrast, Mahathir Mohamad, Malaysia's prime minister, continues to rant against western investors.

Practice and perfection

This survey will explore the prospects for achieving transparency, good corporate governance and sound regulation in developing East Asia. Of course these things matter just as much in other parts of the world: these days, investors everywhere are demanding more from their companies. But in Europe and America, capital markets and corporate institutions have been evolving since the industrial revolution; in developing East Asia, the process is much more recent.

Improvements in corporate governance, according to research by McKinsey, can raise the value of companies anywhere, but for American or British firms the likely benefit is less than 20%, whereas for an Indonesian or Thai company it is closer to 30%. To use the auditors' jargon, the best western companies are now moving from the "conformance" to the "performance" model of governance. This means directors no longer simply comply with the rules but try to do better than that, realising that best practice is a competitive advantage. By contrast, most companies in developing East Asia are still a long way from even conforming.

But in a world where all companies, wherever they are based, are competing for the same capital, they must all try to perform. In Asia, says Mark Mobius, a fund manager with Britain's Templeton group and one of the most experienced investors in the region, "The difference between buying and not buying to a large extent now hinges on minority shareholders' rights." To understand that, consider what happens when those rights are absent.

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Empires without umpires

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Asia's business culture is good for tycoons, not shareholders

MEET Robert Kuok, the quintessential Asian tycoon. Ethnically Chinese, Mr Kuok spent several of his eight decades collecting bitter memories of abuse by the Malay majority in his native Malaysia. So Mr Kuok, like most of South-East Asia's *huaqiao*, or overseas Chinese, early on made it his aim in life to build a better future for his children. This meant amassing wealth, spreading it across countries and industries to reduce risk, and above all keeping quiet about it.

EPA

Tan's secrets of the pyramids

He began in the 1950s and 60s by cornering the markets for flour, palm oil and sugar in Malaysia. He then branched out into practically everything, from manufacturing to property, from hotels to media. Today, he commands a sprawling empire, managed by sons, nephews and in-laws. Its headquarters have been, at various times, in Malaysia, Singapore, Indonesia and Hong Kong. To protect himself, he likes to be everywhere in the region and nowhere; exposed to every industry and reliant on none.

Gregarious and chatty, Mr Kuok nonetheless ensures that virtually nothing of substance is known about him. A few years ago, a big international investigative agency probed deeply into the Kuok empire and produced a report that included this profile of the patriarch: name—Robert Kuok; political affiliation—unknown; adversaries—none identified; litigation—nothing known; ambitions—not known.

His Confucian management style is equally legendary. At a recent lunch he hosted, one of his guests put a question to Mr Kuok's fortysomething, western-educated son Ean, who runs Hong Kong's main English-language newspaper. But just as Ean started to answer, his father noted that it was time for another helping of garoupa, Mr Kuok's favourite fish, and sent his son out of the room to order more. The incident left little doubt about who did the talking in the family.

Mr Kuok embodies "Asian values" in business just as Lee Kuan Yew, Singapore's senior minister, who coined the term, does in politics. Culturally, Asia's tycoons feel Confucian, with all that implies about hierarchy, authority and loyalty (see article). They disdain market research; instead, they act with legendary speed on gut instinct. For information, they turn to their "bamboo network" of other *huaqiao*, or to local politicians. They much prefer to do business with other members of this network, and seal their deals on trust, not contracts. Reflecting both their sense of political insecurity and their origins as traders, they also tend to approach business one transaction at a time.

For decades, this corporate culture appeared to produce tremendous results. Were it not for the Asian financial crisis, it might still be held up as a model in business schools across the world. Although the *huaqiao* are minorities in most South-East Asian countries, they control the majority of their host countries' wealth and stockmarket capitalisation (see table 2). And although these economies have suffered badly in the crisis, the share of the *huaqiao* has barely changed.

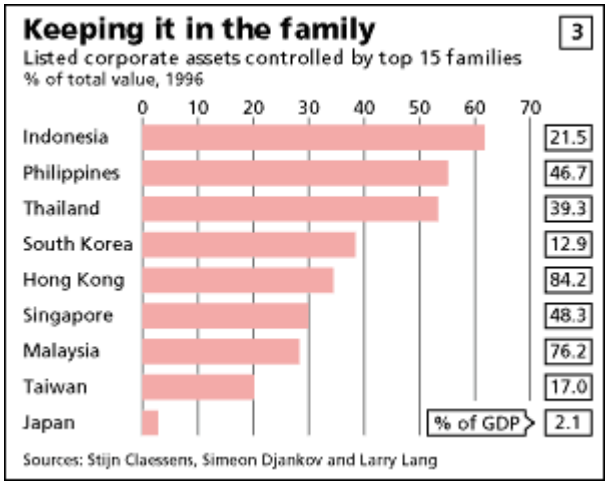
Punching above their weight 2

Overseas Chinese:

	Share of population, %	Share of market capitalisation, %
Indonesia	3-4	73
Malaysia	30	69
Philippines	2	50-60
Singapore	78	81
Thailand	14	81

Source: Economist Intelligence Unit

But there was a snag. The conglomerates of the *huaqiao* (and the tycoons from the ethnic majorities who imitated them) evolved to suit their environment. The resulting business cultures were optimal for a first-generation founder to establish a decent-sized family business. At a certain point, however, further expansion required outside capital. And here the problems started, because outside capital, whether debt or equity, has a side-effect: the dilution, and perhaps loss, of family control. For a founding family, ceding control is always painful. For most of South-East Asia's *huaqiao*, it was simply unacceptable. Protecting their families, after all, was the whole point of their businesses.



Larry Lang and Leslie Young, two finance professors at the Chinese University of Hong Kong, and Stijn Claessens of the World Bank, have analysed the resulting corporate structures in a study entitled "Dividends and Expropriation". For many *huaqiao*, they found, the answer lay in "pyramids": extraordinarily complex and opaque structures of private holding companies, layers upon layers of subsidiaries, as well as cross-holdings and informal links with yet more companies. Almost always, the pyramids included at least one bank with a licence to take deposits, and several publicly listed subsidiaries that could issue shares in the open market.

The purpose of these pyramids was to draw outside capital into the family group while retaining control over the use of this capital within the family. South-East Asia's corporate conglomerates, in other words, aimed to "internalise" the capital markets that discipline companies in the West.

To see how this works, picture a pyramid at the top of which sits a private holding company owned by the patriarch and his family. It owns 51% of subsidiary A, which owns 51% of subsidiary B, which owns 51% of subsidiary C, which owns 30% of company D. Separately, the family also has another (wholly-owned) vehicle, F, which owns 21% of D. In terms of voting rights, the patriarch and his family therefore control 51% of company D. At the same time, the family can claim only 25% of company D's profits (51% times 51% times 51% times 30%, plus 21% through company F).

This discrepancy between the family's voting rights and its share of profits in the company at the bottom of the pyramid is crucial. It creates an opportunity, and indeed an incentive, to expropriate the outside investors in company D and its parents. How? One way is for the controlling family to make company D pay miserly dividends. Better still, the family could make company D sell an asset to company F at an artificially low price, or make company D buy an asset from F at an inflated price. For example, D might be a construction company in Thailand that buys land and concrete from F, paying $100m more than the market value. The family would lose $25m through its ownership of D, but gain $100m through company F, netting $75m. Meanwhile, minority investors in A, B, C, and D would all lose out.

In practice, though, the transactions tend to be more complex, and therefore harder to trace. Consider, for instance, the business affairs of Lucio Tan, probably the wealthiest *huaqiao* tycoon in the Philippines and a close friend of Joseph Estrada, the former president. Mr Tan has interests in airlines, banking, breweries, tobacco, property and much else, and holds these interests in several extremely complex pyramids. Near the bottom of one of them is the Philippine National Bank (PNB). In 1999, the Philippine government owned 46% of PNB, and Mr Tan and other investors had minority stakes. When the government decided to offer new shares, some of them were bought by Mr Tan direct, and the rest were acquired by four special-purpose companies that were financed, it turns out, by loans from banks linked to Mr Tan. As collateral for the loans, the four companies assigned 93% of their voting rights to none other than Mr Tan.

Suddenly PNB became a very different bank. In November 1999, it disclosed that all of its outside directors had resigned from the board and had been replaced by associates of Mr Tan. Mr Tan himself started playing an active role in managing day-to-day operations. Almost immediately, PNB lent $95m to Mr Tan's brewer and his airline, in which he has much higher ownership stakes. Within months, these loans were restructured, with a later repayment date and a lower interest rate. PNB's auditors reckoned that in all probability the loans would never be repaid. The shares dived. In the summer of 2000, Mr Estrada's government decided to sell another batch of shares in PNB to the public. This time there was only one bidder—Lucio Tan.

Variable geometry

To put South-East Asia's pyramids into perspective, finance students at the Chinese University of Hong Kong examined 3,000 East Asian companies, using publicly available information. They discovered huge differences across the region, reflecting the stage of economic and institutional development of the countries concerned. In Japan, fewer than 10% of companies were controlled by a single family—about the same proportion as in parts of Europe. In the next most developed economies, South Korea and Taiwan, just under 50% of companies were under family control. In Thailand and Malaysia, the ratio rose to between 60% and 70% of companies, and in Indonesia and the Philippines, the least developed in this group, even higher. In these countries only ten families controlled over half of their countries' total market capitalisation.

Even more important, however, are the differences in the "visibility" of family control. Mr Young, for instance, discovered that listed companies in which the founding families have fairly large and traceable stakes pay higher dividends; they are under surveillance from the capital markets. By contrast, companies whose ultimate ownership is unclear paid unusually low dividends, suggesting that minority shareholders are indeed being exploited.

The proportion of "visibly" family-controlled listed companies in South-East Asia is not that different from, say, France or Italy. But the share of companies where ultimate control has been disguised is five times higher in South-East Asia, says the study. And that takes in only those companies that were still recognisable despite the disguise. Allowing for those that hide successfully, the real ratio is probably much higher.

What, if anything, about all this is peculiarly "Asian"? It is not the presence of family businesses on the stockmarket, since this can also be found in continental Europe (though less in the "Anglo-Saxon" equity cultures of America and Britain). Nor is it the temptation of founders to dole out senior management positions to family members, or to take outside investors for a ride—again, magnates in Europe yield to both from time to time.

Instead, the main difference appears to be that in western countries the capital markets have had time to catch up with the tricks of family businesses. Regulators, lawyers and judges pay close attention, and creditors and shareholders demand to be represented on the board. All the institutions of mature capitalist systems have evolved to check the power of controlling shareholders and protect the rights of minority investors. Asian capitalism, too, needs to grow up. But how long will it take?

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The ancient art of making money

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From The Economist print edition

NEVER mind, for now, that many of Asia's *huaqiao* are Christian, and that the mainland Chinese are—nominally—Communist and nothing else. Most westerners doing business with the Chinese are convinced that they are confronting inscrutable mentalities. Western capitalism has clearly been influenced by thinkers such as Max Weber and his ideas about the Protestant work ethic. Has the orient's way of doing business been shaped by eastern philosophies?

The usual suspect is K'ung Fu Tzu (Confucius), an itinerant teacher who lived around 500 BC. Master K'ung codified what he saw as the crucial relationships—those between ruler and subject, father and son, husband and wife, elder and younger brother, and friends—and defined clearly who was to obey whom.

An irony that may have escaped Asian tycoons who take him as their model is that Master K'ung himself would have held them in disdain. The profit motive, the Master felt, was highly suspect. In fact, all the commercial classes were to be treated with extreme caution, since they were not tied to any one place and were therefore hard to tax, rule and—yes—trust.

The relevance of Confucian ethics in modern business is limited, however, for a simple reason: Master K'ung did not have much to say about interactions with strangers, which is what suppliers, customers, minority shareholders and creditors tend to be. This gap is elegantly filled by Sun Tzu, a contemporary of Master K'ung, whose opus "The Art of War" has become required reading at many western business schools. Sun's philosophy consists of a great many ingenious stratagems for outwitting an opponent. Sun's is the eastern philosophy that western businessmen are most afraid of encountering—and try hardest to employ themselves.

Another of China's giant thinkers is Lao Tzu, whose philosophy became known as Taoism. Lao stressed the importance of action through inaction (*wu wei*), of letting go and not resisting nature's way of achieving balance. Taoism chimes well with a free-market economy, and even offers a way of explaining Asia's bust after the boom.

One way of pinning down the philosophical differences may be to consider what the West has that Asia does not. In transcendental monotheism, an abstract and authoritarian ruler lays down the law in negative terms ("Thou shalt not..."). As a basis for, say, contract and securities law, this works well. Since business dealings by their nature involve a clash of interests, it is useful to have recourse to a set of universal principles.

By contrast, many Asians find it hard to accept the idea of, say, an external auditor or an independent board director, since he might actually disagree with them. And western hard-headedness puzzles them. After all, a contract was signed in a context. And if that context has changed, has not the contract?

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The best and the rest

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Surprisingly few companies in Asia's former tiger economies are in the first category

STAN SHIH, the chairman and chief executive of Acer, a large Taiwanese computer maker, readily concedes that he is unusual in his part of the world. "I recognise the weaknesses of the Chinese," he says. "I'm talking about business values." So Mr Shih has decided to identify those values, expel them from Acer, and replace them with what he sees as international best practice.

EPA

Two Lis are better than one

For a start, he banned his daughter and two sons from ever working for his company (his second son got a summer internship, but that was it). Confucius might have turned in his grave, and much of Taiwan thought he was mad. But Mr Shih felt that it would have been unfair to his children (because of the pressure), to his colleagues (would they hit a glass ceiling?), and above all to his shareholders (were the kids the best managers?).

Next, Mr Shih started paying his managers in shares, long before most other employers in Asia even thought of it. He invited outside directors on to the board, and started publishing detailed audited accounts every quarter, even though Taiwan requires only annual statements. He told his employees, regularly and loudly, that human nature was not selfish, as the Chinese often presume, but good. He also made it clear that he expected them to disagree with him openly, and that failure was all right provided it was for the right reasons.

His eccentricity thus established, Mr Shih committed the ultimate Chinese iconoclasm by declaring: " 'No control' is our principle." Not only was the Acer group to be flat, rather than pyramidal, but the holding company would own no more than 30% of each subsidiary, and Mr Shih himself would control no more than 5% of the holding company. Each part of the Acer group was to stand alone, to be transparent, and to have representatives of outside investors on the board. "All my decisions are to protect my minority shareholders," says Mr Shih. "I need their support." And he gets it, from 400,000 of them.

If Mr Shih ran an American or a British company, such attitudes might win him praise. In Asia, however, they make him a pioneer. A look at Asia's former tigers and tiger cubs reveals a mere handful of companies that are seriously trying to change.

If Taiwan looks relatively good in this respect, this is thanks to its large high-tech industry. Firms such as Taiwan Semiconductor Manufacturing Company, for instance, the largest independent (ie, non-branded) chip maker in the world, have long had to compete in a global market against global rivals, courting global investors and using global rules. This has left Morris Chang, TSMC's chairman, little choice but to bring corporate governance and transparency up to international standards. The same is true for global industries elsewhere in the region. Singapore Airlines, for instance, the island-state's flag carrier, is a well-managed company despite the government's majority stake. Singapore is unusual, moreover, in that it has a legal system sound enough to keep managers honest.

In Hong Kong, Li Ka-shing, emerging Asia's biggest tycoon by far, appears to have blended the business culture of the overseas Chinese with some elements of international best practice. Once a poor immigrant from mainland China, Mr Li started by selling plastic flowers on Hong Kong's streets, later moved into property, and in the late 1970s became the first Chinese tycoon to take over one of the old British trading houses, or hongs. Today, via his two corporate flagships, Cheung Kong and Hutchison Whampoa, he has worldwide interests in telecoms, ports, retailing, energy and much else.

Mr Li is a dominant figure in the bamboo network. His elder son, Victor, sits on Mr Li's boards and is being groomed for succession. The younger, Richard, has become something of a telecoms tycoon in his

own right. Mr Li senior's leadership style is secretive and authoritarian. He "sees no value in independent directors disagreeing with him," according to one insider. And Mr Li's corporate structures are among the most complex pyramids in Asia, designed to maximise the Li family's control with minimal capital. Monitoring transactions within this empire is a daunting task.

A little something for the shareholders

Nonetheless, Mr Li's companies rank among the few that international investors have consistently trusted with their money, even through the crisis. Family considerations do not appear to have interfered with Mr Li's ability to choose and attract the best managers, be they Chinese or western. And even if minority shareholders have little say in the running of the empire, Mr Li appears to have resisted the temptation to exploit them: "He always leaves enough for us on the table," as one investor puts it. "We operate the company western-style, although with an eastern touch," says Canning Fok, who runs Hutchison Whampoa and is Mr Li's most trusted manager besides his sons.

Another mildly encouraging example is Charoen Pokphand, the largest conglomerate in Thailand, whose interests range from chicken feed to telecoms. In the boom years leading up to 1997, the ethnic-Chinese Chearavanont family that controls CP expanded recklessly, but since the crisis the family has changed its ways. It has begun to focus the group more tightly, selling supermarkets, a brewery, a motorcycle maker and several pharmaceutical subsidiaries. It has also made the business more transparent. When it recently tried to inject several privately held companies into the listed arm at dubious valuations, it actually listened to complaints by minority shareholders and is now negotiating with them. "They're torn between allegiance to the family and to the shareholders," says Mark Mobius, whose Templeton fund has a 7% stake in CP.

In stark contrast, the companies that inspired the most optimism in the early days of the recovery have since proved the most disappointing. The families who run South Korea's industrial conglomerates, or *chaebol*, are not ethnic Chinese, and their business empires are different from those of South-East Asia. But they have been among the worst sinners during the Asian boom years, investing with no apparent regard for economic return and, collectively, running up debts five times the size of their equity. Throughout 1999, however, South Korea's government appeared determined to force the *chaebol* to sell assets, reduce debt, produce more transparent balance sheets, and appoint independent directors to their boards. For some time, investors were hopeful, and the stockmarket rebounded.

In the second half of last year, however, it became clear that corporate reforms were getting bogged down in politics, and that the old dynastic business culture was reasserting itself with a vengeance. Hyundai, the largest *chaebol*, was embroiled in a bitter succession feud between two sons of the patriarch, and management was split into hostile camps. Daewoo, the second-largest, had become insolvent in 1999 and was trying to sell its bankrupt car division to Ford, but the Americans walked away during the due diligence, presumably after learning how bad things really were. Daewoo is now negotiating with GM. Its former chairman, Kim Woo Choong, is accused of the biggest accounting fraud in history, and hiding abroad.

Among the big *chaebol*, only Samsung still claims to be on track with its reforms. Yet even it is missing the point. In line with the government's new guidelines, for instance, Samsung has appointed a few independent directors to its boards. Yet Kim Seong Bae, a director in charge of restructuring, still wonders why they are there. They appear, he says, only to "hinder speed in decision-making".

Unreconstructed

It gets worse. In Malaysia, at least in the biggest conglomerates, there has been no change whatsoever. The country's tycoons, whether ethnically Chinese or *bumiputra* (ie, Malay, and thus favoured by a policy of affirmative action), regularly put outside investors at a disadvantage with the same old intra-pyramid transactions as ever. Mahathir Mohamad, rabidly hostile toward western investors and markets in general, is still prime minister, and his cronies in business remain unreformed.

Thailand and Indonesia, moreover, have had little chance to think about shareholder rights because they are still bogged down with the problem of creditor rights. In 1998, virtually their entire corporate sector was insolvent, and much of it remains so today. Investors discovered that neither country had a proper bankruptcy code. The necessary laws are now in place, because the IMF made its help conditional on their introduction. But the courts, many of them staffed by venal judges who have never dealt with

bankruptcy before, are out of their depth.

The results range from tragedy to farce. In 1999, an accountant from a big international auditing firm was murdered outside a Thai sugar mill whose debts he was supposed to restructure. The patriarch of the country's largest debtor, Thai Petrochemical Industries (TPI), is still fighting against creditors to keep control of the company. In January, a court finally ordered him to resign, but he still parks his car in the chairman's space, and has yet to sell a single asset to repay his debts. Experts estimate that one-third of Thailand's bad loans are now in default thanks to "strategic non-repayment"—meaning that debtors have the money but refuse to hand it over. In Indonesia in January, a company went further: it created fictitious creditors, hoping to vote down the real creditors who were pushing for liquidation. Its ruse, however, was discovered.

In short, corporate change in most of developing East Asia has not got very far. As the World Bank's top official for Thailand puts it: "The same guy is sitting there, so if you want to work on them, it's going to take a long time." Moreover, as the economic crisis becomes less acute, a backlash is gathering strength. Many tycoons still regard best international practice as an unnecessary cost, or even an instrument of western economic colonialism. It was this mood that earlier this year helped the election of Thaksin Shinawatra, a business tycoon being investigated for failing to report assets as required by the National Counter-Corruption Commission, as prime minister of Thailand. For those investors still fighting for their shirts in the region, all this is a pity. But new investors have stopped caring, because they have turned their gaze to the north.

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From bamboo to bits and bytes

Apr 5th 2001
From The Economist print edition

THE Internet is taking parts of East Asia by storm. South Korea and Singapore already rank among the world's most wired economies, and Hong Kong and Taiwan are not far behind. In the troubled economies of South-East Asia, by contrast, only Malaysia shows promise. Assuming that they will all become avid netheads in due course, what effect will that have on the local business culture?

The biggest would be to fill South-East Asia's "informational black hole", a phrase coined by George and Usha Haley and Chin Tiong Tan in an important study of overseas Chinese tycoons, "New Asian Emperors" (Butterworth-Heinemann, 1998). Developed economies are awash with public data to be crunched and pored over by analysts and market researchers. South-East Asia, by contrast, is conspicuously devoid of public information. That makes it hard for foreigners to do business there, but suits local tycoons splendidly. In the absence of public sources, information of any kind becomes private and privileged. It creates opportunities without risk. That is why the "bamboo network" of whispers and winks has proved so successful in the past.

Finding public information about the lack of public information is tricky, but Mr Haley and his colleagues had a good try. They used articles written about business in the region as a proxy, and found that in the late 1980s, when foreign investors were getting interested, Asian business received only 5% of the coverage of American business. In the early 1990s, as the tigers became more fashionable, coverage of Asian business went up, but not by much; and, surprisingly, when the tiger bubble was at its biggest, the number of articles declined. What little coverage there was, moreover, was mostly of tiny but developed Singapore.

The Internet could help to eliminate this black hole. Because the net makes it easier to disseminate information, it should also encourage people to gather more of it. And once new information pops up all over the world's computer networks, the value of the stealthy bamboo network will decline. Simon Cartledge, who produced a study on the bamboo network for the Economist Intelligence Unit, a sister organisation of *The Economist*, argues that in future, "Whom you know will matter less than what you know," even for the overseas Chinese. And that would spell the gradual end of bamboo business as they know it.

Mr Cartledge takes the thought further. The Internet is universal and open; the tycoons are secretive. Its mass audiences are made up of strangers; the tycoons trust only insiders. It busts tariffs and other trade barriers by introducing online competition (in banking, say); the tycoons rely on closed markets and monopoly rights. The Internet and the tycoons, it would appear, will not be friends.

In fact, the Internet may turn out to be quite an insidious enemy. Because it requires creativity, it forces companies to compete for talent. And talent in this field, even in Asia, tends to reside in the same sort of pony-tailed, geeky and individualistic people as in California. Obedience to the Confucian elder? They want responsibility. Firm handshake of trust? They want share options. So perhaps, one day, the Internet will prove effective in unravelling the bamboo network and obliging tycoons to change their style. But not just yet.

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The giant stirs

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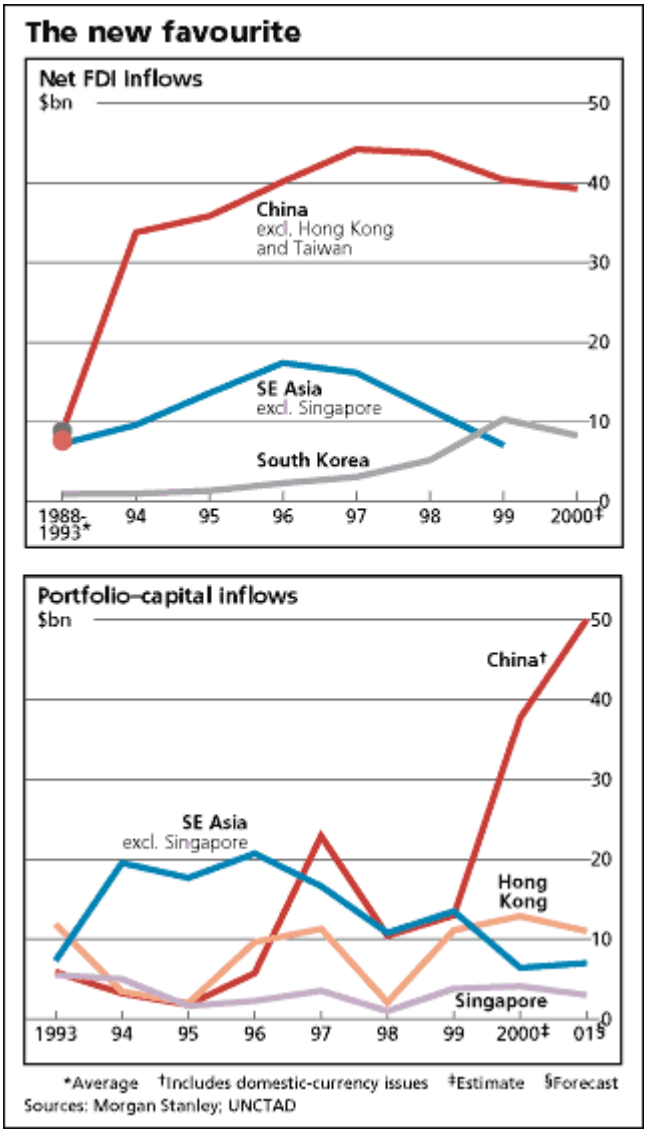
From The Economist print edition

In the search for well-governed companies in Asia, all eyes are now on China

AMONG veteran investors in Asia, a consensus is evolving. Ask, for instance, Samson Li at the Bank of East Asia, Hong Kong's largest family bank and one of the region's best-connected. In the early 1990s, the bank had 45% of its money in Hong Kong and Singapore, and the remaining 55% in Thailand, Malaysia, Indonesia and the Philippines. These days, the portfolio looks rather different. The bank keeps an even larger chunk (60%) of its money in Hong Kong and Singapore, but the rest is now entirely in mainland China and South Korea. Its exposure to Thailand, Indonesia, Malaysia and the Philippines is zero. "I hate them and will never trust them any more," says Mr Li.

This transfer of affection away from South-East Asia and toward China has been the most striking development in East Asian finance since the crisis. Looking at foreign direct investment (FDI), for instance, Indonesia's inflow of $6 billion in 1996 turned into a net outflow of $4 billion last year. China, by contrast, received almost $40 billion. This worries South-East Asians. "We watch very closely the FDI numbers, and how China is sucking in a very large part of the total available," says Singapore's trade minister, George Yeo.



The flows of portfolio capital tell the same story. Last year, Chinese companies raised some $20 billion from foreign equity investors, compared with a combined total of $5 billion for all other countries in the

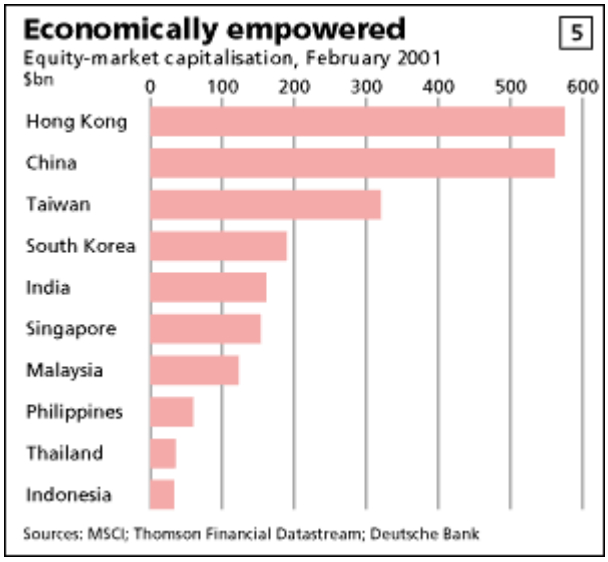
region (but mostly South Korea). Most of this money enters via Hong Kong, where a third of the market capitalisation now represents mainland companies. This is because China still keeps foreigners out of its domestic (ie, yuan-denominated) stockmarket, which, barely a decade old, is already the third-largest in Asia after Hong Kong and Tokyo. Eventually, the government intends to integrate these pools of liquidity. And when that happens, says Stuart Leckie, the chairman of Woodrow Milliman, an investment consultancy, China will rank with America and Japan in the world's top three.

Size matters. American pension funds such as TIAA-CREF, for instance, are larger than the stockmarkets of Malaysia, Thailand, Indonesia and the Philippines combined. This means that many institutional investors are no longer able to take positions in South-East Asia, even supposing they wanted to, because they would instantly move prices against them. By contrast, shares in, say, China Mobile, the mainland's main mobile-phone operator, are liquid enough even for the big boys.

The underlying Chinese economy is looking enticing too. Andy Xie, the regional economist for Morgan Stanley, an investment bank, predicts that in 15 or 20 years' time, China will become "the next $10 trillion economy after America". Moreover, there is something special about China's expansion. Not only has the economy been growing faster than any other over the past six years, but in stark contrast to other emerging markets this growth was not volatile. Even now, as economists scale back their growth forecasts for most of Asia to reflect falling demand from America, their projections for China remain unaffected. The reason: China's economic growth is, to a large extent, generated domestically rather than by exports. Last year, China was one of only two countries in the world (the other being Venezuela) whose stockmarkets moved in the opposite direction to America's—which reflected its growing economy.

Panda, bull and bear

China, in fund managers' jargon, is a "restructuring play"—probably the biggest in economic history. Since 1978, when Deng Xiaoping embarked on reform, the country has been transforming itself from one of the world's worst planned economies into a market economy. The Communists in charge prefer to talk about "socialism with Chinese characteristics" rather than "capitalism", and "corporatisation" rather than "privatisation", but that does not make them any less enthusiastic.



For all these reasons, it is easy to find "China bulls", especially outside Asia. But many long-standing investors in China are less impressed. "I'm jaded," says Bill Kaye, who runs a hedge fund out of Hong Kong. "Billions go in, but how much is coming out?" No matter how much wealth China creates, he says, foreigners rarely see any of it in the publicly listed markets. Corruption, market-rigging and accounting fraud seem likely to keep things that way.

This should not be surprising, given that China emerged from the Cultural Revolution of the 1960s without even the remnants of the institutions that market economies elsewhere take for granted. It had factories that were run by ministries as welfare organisations, but no "companies". It had no "property", and so no "assets", "liabilities" or "equity". It lacked concepts such as "bankruptcy" and "contract". In fact, China had no legal system in any conventional sense at all (of which more later).

Since then, it has set about trying to build these institutions with a remarkable sense of urgency. The country's leaders realise that their reforms are causing social dislocation. After massive layoffs, most state-owned enterprises (SOEs) are still overstaffed by between a third and a half, say analysts. China's private sector is energetic and growing, but still far too small to absorb these workers. To keep the reforms on track and prevent unrest, the government must therefore keep, and in many cases resume, paying pensions and unemployment benefits. And that takes money.

This explains the Communists' sudden love affair with bourses. "The Chinese government understands that it needs the stockmarket more than the reverse," says Mr Xie. In the past decade, China has brought over 1,000 SOEs to market, and plans to list as many again in the decade ahead. Of these, the relatively few overseas listings, in Hong Kong, New York and London, play a special role. One of their uses is to raise foreign currency to meet domestic welfare liabilities. But more important, they are a way of "outsourcing" regulatory and legal regimes. The idea is to expose the top SOEs to best practice in outside institutions so that managers can concentrate on achieving best practice internally, in corporate governance and disclosure.

The objective is not so much to please foreign investors as to learn their rules, so that they can be applied in China for the protection of local investors. "Even if all foreign capital went away," says Tim Rucquoi-Berger, an entrepreneur who restructures and sells SOEs, "they would still do it—in fact even more." This may seem odd, given that the government does not seem keen on empowering its people in any other way. But China has 60m retail investors—essentially its entire urban coastal middle class. Denying such people their economic rights would be politically unwise. Mobilising their savings efficiently (ie, through the stockmarket rather than the state-owned banks), on the other hand, promises rich rewards.

But if China is aiming for well-governed companies bought and sold on well-governed bourses, the odds appear stacked against it. For example, there is a growing suspicion that the domestic stockmarkets' stellar performance reflects nothing more than market manipulation by a few dominant brokers (colluding naked in bathhouses, according to some reports, for fear of being bugged). In February, one of the country's most respected economists, Wu Jinglian, complained that China's stockmarkets were "worse than a casino". Securities regulators have now begun a crackdown so fierce as to send the markets diving.

Too many mothers-in-law

The picture inside companies looks no better. It is an ironic legacy of Communism, says Mr Rucquoi-Berger, that government is dictatorship and business is anarchy. The Chinese call this the dilemma of too many *popos*, or mothers-in-law. The *popos* include bureaucrats at every level of government—from local party cadres to provincial and national officials—who have, for their entire careers, been siphoning resources from the SOEs, and even compete with one another for the biggest share.

Those SOEs that rise above anarchy tend to adopt a form of governance known as the "key man model". The key man is the chairman, chief executive or a high-ranking Communist (usually all three) who has almost total discretion over management, investment decisions, and even internal auditing. The rest of the board rubber-stamps his decisions.

That is one reason why the balance sheets of Chinese companies are, by common consent, a joke. In January, the government's official auditing body admitted that more than two-thirds of the 1,300 biggest SOEs cook their books. Johnny Chen, the Beijing head of PricewaterhouseCoopers, says that even this is an understatement. Quite simply, the SOEs' numbers are whatever the key man wants them to be. And without genuinely independent directors to chair an audit committee, that will not change.

Yet many investors remain optimistic, not only because China is too big to ignore but because companies run by the Chinese on the mainland are different from those run by the Chinese in South-East Asia. China's SOEs do not have to worry about founding families refusing to give up control, because they are owned by "the people", meaning the government. "We're in a much better position than South-East Asia," says an official at the China Securities Regulatory Commission, "because our interest groups don't have that much of an interest in their own interests." So if the government as majority shareholder decides to favour minority shareholders, best practice becomes possible. For an example, consider one of the biggest SOEs: Sinopec.

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A lesson in capitalism

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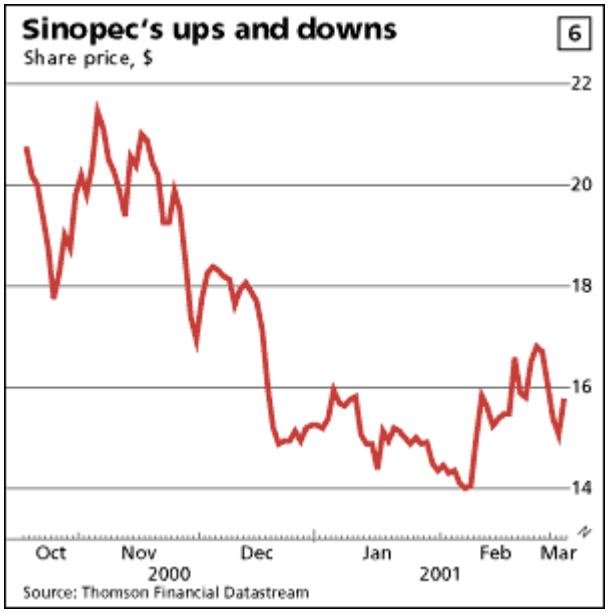
Sinopec, Asia's largest oil refiner, provides clues to what is and what is not possible in China

"WE MUST face the future," reads the calligraphy draping a distillery in Yanshan, about an hour's drive north of Beijing. Yanshan, with a population of about 100,000, is a drab dustbowl; but it is also a petri dish of China's corporate reforms. Everything and everybody here has something to do with refining oil or turning it into various kinds of chemicals. The city itself consists mostly of rather odorous refineries and endless tangles of pipelines, vents and ducts connecting them. Around these nestle grey housing blocks, schools and hospitals for the workers and their families. All of this used to be managed, if that is the word, by central planners in a Beijing ministry.

Lately, the people of Yanshan have been in a state of permanent revolution, although not of the sort that Chairman Mao had in mind. At first, the changes were only skin-deep. Asphalt replaced dirt roads; housing units got running water. But then Yanshan joined thousands of other oil towns across China in becoming part of a "company" called China Petroleum & Chemical Corporation, or Sinopec. Some time later, word got out that this company, and therefore the town, would be split into two parts, one of which was to be "listed" on stockmarkets abroad. Nobody knew what a listing was, but it soon became clear that it was safer to belong to the listed part. According to one resident, a "sense of crisis and foreboding" pervaded Yanshan.

In late 1999 and early 2000, bankers and accountants started turning up in large numbers. Some were foreigners, most wore expensive suits, and all behaved as though they owned the place. The auditors, from KPMG, buried themselves in piles of paperwork. The bankers, from America's Morgan Stanley, which is the most influential investment bank in East Asia, had the more ominous role. It was they who would decide which buildings and workers were to be in the listed company and which were not.



The decision was made in the spring of 2000. Only the refineries and chemical plants would make the grade and become listed. This was a blow to workers in the remaining part—Yanshan's power station, schools, hospitals, and so on. They would continue to supply services to Sinopec for a while, but on increasingly strict commercial terms. Ultimately, they were to be severed completely from the listed company and left to sink or swim on their own. "Listed" families suddenly strode around town with new pride and optimism, while their "unlisted" neighbours sulked in envy or fear.

Today—six months after the listing—the mood in Yanshan has changed again. The "listed" employees have discovered a new ambition. They want to take on the "super majors", such as BP Amoco, Exxon

Mobil and Royal Dutch/Shell (which also took stakes in Sinopec). BP, in particular, as a former state-owned enterprise, serves as a role model.

Emancipation by IPO

This new-found confidence in towns such as Yanshan should come as a relief to three groups of people: Beijing's top Communists, Sinopec's top directors and its foreign minority shareholders. For the first two groups, say managers, the main point of the share issue was never to raise money—the $3.5 billion injection was welcome, of course, but a behemoth such as Sinopec can get all it wants from the state-run banking system. Rather, the idea was to be taught discipline by minority shareholders in the toughest markets in the world—hence the additional listings in New York and London, even though Sinopec's trading volume there is low.

To investors, the share offering was an opportunity to get in on one of the most promising oil franchises in the world—but at the price of becoming guinea pigs in the government's reform programme. The parent company, an arm of a government ministry, not only retains an 80% stake in Sinopec, but still has all those schools, hospitals and power stations to look after. Investors feared that the parent company's interests would conflict with their own, and that they would fall victim to social unrest, or perhaps to a backlash of Communist hardliners. That risk now seems manageable, but it remains.

The scale of the transformation was immense. For over a year, remembers Carlos Oyarbide, a banker at Morgan Stanley who helped steer the company through this revolution, he and his team worked on re-educating every manager at Sinopec "to look at their company as the markets would look at it". Morgan ran seminars for 100 bosses at a time, teaching, in effect, a foundation course in capitalism (although the word itself was banned). The bosses, who had been used to meeting output quotas, had to wrap their minds round concepts such as the cost of capital, free cash flow and shareholder value. It was a huge culture change.

Almost every recommendation that Morgan Stanley made, moreover, amounted to political iconoclasm. The most obvious was the retail price of Sinopec's main product, petrol, which was still regulated by the government. The bank first persuaded Sinopec's chairman, Li Yizhong, that this price-fixing was a deal killer. Next, it had to get Mr Li to persuade Zhu Rongji, China's prime minister, that liberalisation was essential. It would mean that taxi drivers, farmers and fishermen across China would have to pay more for fuel. But it was done.

But the worst part was to reform corporate governance. Morgan Stanley insisted on measure after measure to separate Sinopec from its parent, so that outsiders could be convinced that transactions between the two would be at arm's length. Hence all the nail-biting in Yanshan a year ago. The bank also insisted that no employee in the listed company could also work for the parent company. In the end, only one exception was made—for Li Yizhong, who remained chairman of both.

But minority shareholders still needed reassurance that they would have a voice. So Sinopec agreed that all "major" decisions (a new share issue, say) would have to be submitted to two separate shareholders' votes—one at a general meeting, where the state would get its way, and one at a meeting for overseas shareholders only.

The bank also pressed for a board with independent directors, which at first was a non-starter for the Communists both at Sinopec and in the government. In the end, Morgan Stanley got its way, but not quite as intended. Three independent directors were appointed to the board of ten, but "the ones they chose were not our choice," says Mr Oyarbide. Two were eminent but ageing Communist academics, and one a Hong Kong businessman. In time, says one board member, "they will learn to become brave enough to raise different voices." In other words, so far they have toed the party line.

That is exactly what worries investors such as Bill Kaye, who runs Pacific Group, a hedge fund that has been in and out of China for a decade. "I wouldn't touch Sinopec with a bargepole," he says. For him, it does not matter how good the company is as long as he has no rights as a shareholder. What would it take for him to change his mind? He would want a majority of the board to represent minority shareholders. To take an extreme case, if it were in those shareholders' best interest to sell the company to a hostile bidder, the board would have to do it.

It is the sort of thing that Sinopec's brand new investor relations team hears all the time. It even listens. One board member says that Sinopec is currently looking for a fourth independent director, possibly even

a foreigner from one of the oil majors that bought stakes in the company. In a few years, he hints, Sinopec might even contemplate giving outsiders a majority.

Thoroughly modern

In the meantime, Sinopec is doing its best to change all other aspects of its corporate culture. A good part of directors' remuneration is now in the form of share options. Lest they forget their mission, a fancy electronic display dominates the lobby of the main building, flashing the latest share price of Sinopec and its rivals. Since the government does not trade its shares, this number summarises the verdict of minority shareholders every day. The display is a reminder that some day the market—rather than some party boss—will pass judgment on the managers walking past it to the lift.

Unfortunately, that day is still some way off. For now, Sinopec still suffers from schizophrenia, of which this correspondent got a taste. In line with its new policy of transparency, the company had held out the prospect of a long interview with the chairman. Mr Li would have been Sinopec's best possible advertisement. Fund managers and bankers who have met him describe him as "a visionary leader", "a world-class CEO", "a superior intellect", and "a database that knows numbers down to two decimals." Mr Li is also a high-ranking member of the Communist Party whose credibility with China's leaders was crucial in forcing through the changes at Sinopec.

Yet the meeting never happened. At the time it was due to take place, the Communist Party was preparing for the annual National People's Congress, and its various organs were deliberating on the future of promising individuals such as Mr Li. Much as the chairman would have loved to talk, in the circumstances it was not possible.

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Of laws and men

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From The Economist print edition

Without independent courts and judges, there can be no first-class companies

THE crux of the problem is that "governance can't improve faster than legislation, but legislation can't move faster than social practice," says Jerome Cohen, a New York lawyer who advises foreign clients on doing business in China. So even if tomorrow morning every one of China's chief executives woke up as a passionate believer in good corporate governance, it might still prove elusive. This is because best practice within companies depends on best practice outside companies, above all in the legal system. And China has one of the worst in the world (see chart 7).

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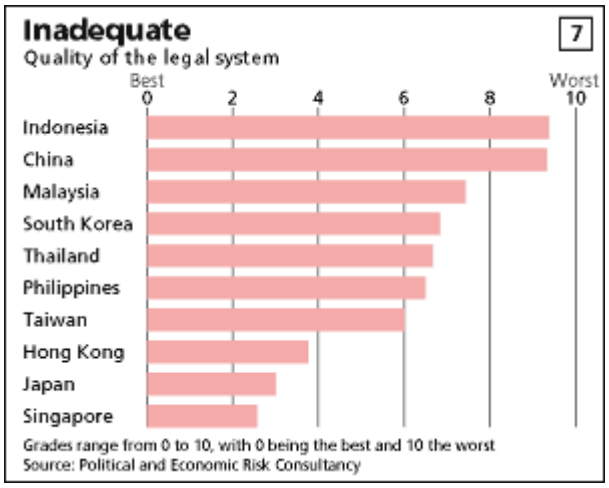
But how independent was the judge?



For that, blame history. David Buxbaum, the only westerner who regularly litigates in Chinese courts, still remembers what China was like when he arrived there in 1972, during the Cultural Revolution. The people who used to be lawyers or judges were doing hard labour in remote provinces; those who might have been studying law were busy as Red Guards, denouncing teachers and parents. The courts were closed. China's old and sophisticated legal traditions had been scrapped. In legal terms, there was anarchy.

In the 1980s and 1990s, China went a long way towards filling this void. Milestones included new statutes for property, companies, contracts and bankruptcy. But fitting all these into a coherent whole is proving fiendishly difficult. For instance, China's laws for joint ventures between local and foreign companies include a clause stipulating that the parties are to share profits and losses in proportion to their investment. At first this made intuitive sense to the Chinese, until they realised that the loss-sharing part of it conflicts with another body of law that defines limited liability. The problem is now being fixed.

But sorting out the internal logic of the legal system is not the main issue. "Everyone can promulgate regulations," says Mr Buxbaum. "It's a question of enforcement." The first barrier, he explains, is that "the people who enforce the laws don't understand what those laws mean." He is talking not so much about lawyers, who are well paid and increasingly well trained, but about judges. China has some 170,000 of them, but they have no proper qualifications (although this may change soon), their social status is low and their pay is miserly. No wonder that bright students tend to become lawyers and not-so-bright ones become judges. And as in other poor countries, being short of money makes judges vulnerable to corruption: "It is the difference between having and not having a refrigerator," says Mr Buxbaum.

The biggest challenge by far, however, is to make the judiciary genuinely independent. This applies not only to China but to many other Asian countries too. Singapore, for instance, has succeeded in ridding its courts of corruption but not of political meddling. Unlike Europe, much of Asia has a unitary political tradition that does not separate the law-making and law-enforcing branches of government. Whereas Europe gradually came to accept the rule of law, China has always been under the rule of man.

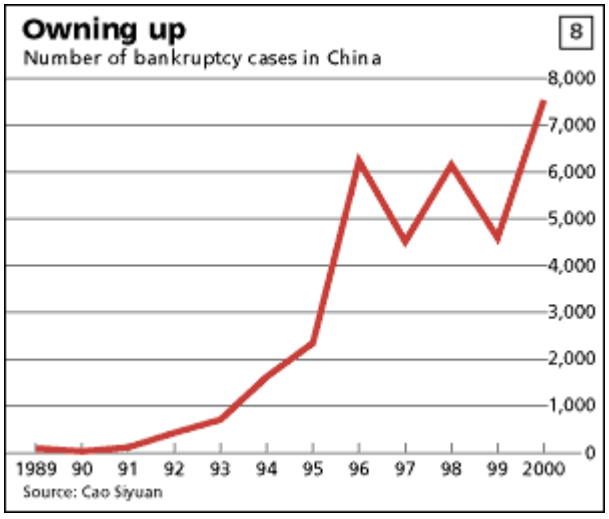
Stand by your man

In practice, the rule of man means that investors can sue all they like in China's courts, but unless they have powerful political connections they will waste their time. This is equally true for Chinese and for foreign investors, but foreigners (and especially Americans, with their litigious culture) tend to find the experience more traumatic.

Take, for instance, the case of a joint venture between a Chinese majority partner and two foreign minority investors. On paper, the joint venture had a proper board of directors. However, its "key man" (the chairman) had ties to the majority investor, whom he blatantly favoured at the expense of the minorities. The foreigners promptly sued. The chairman had a few words with the judge, and the court subsequently challenged the "standing" of the foreigners (ie, their existence as legal persons), and asked them to work it out with the board. The message was that the court did not want to get involved.

Another way for courts to avoid a decision is to allow cases to get bogged down. One egregious example concerned a European company that sold goods to a large Chinese customer. As usual, the trade was underwritten by a Chinese bank, which endorsed the bills of lading on the back and released the goods to the buyer. When both the buyer and the bank suddenly refused to pay, the Europeans took both to a court in Changshu, near Shanghai, where the case was held for three years. It was then transferred to another court, where the foreign company lost because the court ruled that "It was not clear that the plaintiff was the seller". The foreign company appealed to a higher court, but four years after the transaction its case is still pending.

It may be bad, but is it getting better? One way to find out is to look at the number of bankruptcy cases (see chart 8). Cao Siyuan, an outspoken advocate of privatisation and the rule of law, was one of those who drafted the bankruptcy code and helped implement it in 1988. At that time, he recalls, "nobody understood it and everybody was scared of it." Since then, the code has become a political football, bouncing back and forth between the rule-of-man and rule-of-law factions.



In the code's first year, there were only 98 cases in the whole of China, even though, on proper accounting, virtually the entire state-owned sector was insolvent. In other words, "men" clearly had the upper hand over "law" and were able to block bankruptcy proceedings. Following the Tiananmen Square massacre in 1989 and a resurgence of the hardliners in the Communist Party, the bankruptcy code was all but put on ice. But in the early 1990s, as reformers in the government gained the upper hand, bankruptcy cases started rising.

In October 1998, a landmark case put the code to its most severe test yet. The only Chinese enterprises that are allowed to borrow in foreign currency are so-called International Trust & Investment Corporations (ITICs), which are investment arms of local governments. The ITICs tend to be well-

connected, and foreign banks had always assumed that their debts had the implicit backing of the government in Beijing. Imagine their surprise, therefore, when the ITIC of China's richest province, Guangdong, defaulted, along with several others, and the central government made it clear that it had no intention of underwriting their debts. Over two years of extremely messy bankruptcy negotiations, it became clear that the law was vague on everything, from the formation of creditor committees to foreclosure. The banks eventually settled out of court, and for huge losses.

But the ITIC episode may have been a blessing in disguise. By exposing the shortcomings of the existing code, it clarified the issues and set important precedents on procedure. For instance, it turned out that the claims of foreign creditors did not rank ahead of those of Chinese creditors, as the foreign banks had hoped—a decision that supported the principle of equality before the law. After a sharp drop in new bankruptcy cases in 1999, the number soared again in 2000. If the rule of law always prevailed, reckons Mr Cao, that figure should be 17 times higher still. But at least China is moving in the right direction.

The speed at which it does so may well be the single most important variable in China's economic reforms. On pessimistic assumptions, China will take as long as western countries did to build confidence in its legal institutions: decades or even centuries. In a more optimistic scenario, China somehow manages to leapfrog the intermediate stages to move ahead much more rapidly; but this depends entirely on the political will of the ruling party.

The Communists understand that their political survival depends on the success of their economic reforms, and that this requires fixing the legal system; but they have also grasped that fixing it means making the judiciary independent, and that such independence will allow the judiciary to turn against the party. Who knows how far it will allow the courts to go?

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By train, by bus or on foot?

Apr 5th 2001
From The Economist print edition

THE negotiations have been exceptionally long and tortuous, but China could still accede to the World Trade Organisation (WTO) this year. At a stroke, this would lower barriers to foreign trade and competition in a number of industries. But there are also hopes of a more far-reaching benefit: membership might help to bring China's legal system up to international standards.

Long Yongtu, China's chief trade negotiator, is all for it. By joining the WTO, he says, China is above all demonstrating that it wants to "close the gap and get to world standards" in its judicial and regulatory systems and its business practices. To him, membership amounts to aligning China's rail gauges to the world's, so that the train of global trade and capital can power through.

Credit Suisse First Boston (CSFB), an investment bank, chooses a different metaphor: investing in China today, it says, is like taking a strange sort of bus tour. The scenery keeps getting better, but the passengers are aware that they have no idea who is driving the bus, and where. Membership of the WTO, reckons CSFB, solves this problem by underwriting China's determination to move "to best global practice". Who is driving becomes irrelevant, because there will be only one road: the market.

Wu Xiaoqiu, an outspoken professor of finance at Beijing's People's University, is less poetic about it, but he broadly agrees. For two decades, he says, China has been undergoing "active" reforms, in which the government has set the pace; now China is entering the stage of "passive" reform, when the needs of foreign investors and trading partners determine the speed. And they like to go fast.

But other analysts are sceptical. Cao Siyuan, a prominent advocate of China's private sector, thinks that "the WTO can promote but not force corporate change in China." China's government, he reckons, will always go as fast as it wants and no faster. Many western businessmen with experience on the ground echo this view. Mix "socialism with Chinese characteristics" and the WTO, says David Wolf, an entrepreneur and consultant in Beijing, and you get "compliance with Chinese characteristics".

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The greatest leap forward

Apr 5th 2001
From The Economist print edition

Transition from one system to another is the most dangerous phase

LEAVE the centre of Beijing or Shanghai, look for an intersection with heavy traffic, and you are likely to see something odd. Traffic policemen are standing in the middle of the road, directing cars hither and thither in the time-honoured fashion. But around them, new traffic lights have been installed whose lights change regularly from green to amber to red and back again. As you watch, you will find that the signals given by the police often conflict with those of the lights. The drivers seem confused, and occasionally there is a crash.

To Li Shuhe and Li Shaomin, two professors at the City University of Hong Kong, such mayhem is inevitable as China, and most of developing Asia, moves from a relations-based system (the traffic policemen) to a rules-based system of governance (the traffic lights). This transition, they argue, is more dangerous than the old system that is being replaced, and a temporary "governance vacuum promises still deeper pitfalls for the unwary investor."

The familiar word used to describe the old system is *guanxi*. Usually translated as "connections", *guanxi* conjures up images of karaoke outings with officials, nods of understanding in smoke-filled rooms, and the invisible hand not of the market but of influence. *Guanxi* is a cliché, but it is only too real.

Western investors tend to assume that Asian tycoons turn to *guanxi* for deep-seated cultural reasons, but in fact they do so out of necessity. Both a rules-based and a *guanxi*-based system of governance incur expenses. For both, these are made up of the fixed costs of keeping the system running—say, training and paying judges, regulators and auditors—and incremental costs, such as the effort and expense of signing one more contract, sealing one more transaction, and so on.

Developed economies have rules-based governance systems that incur enormous fixed but negligible incremental costs. The fixed costs, however, are spread over huge numbers of transactions and business relationships, so that the average cost of any single deal is quite low. By contrast, the poor countries of Asia so far have not been able to afford the investment in the high fixed costs of such a system, and have therefore settled for the large incremental costs of a *guanxi*-based system. As long as the number of transactions and business relationships remained comparatively small, the average cost of the transactions was bearable.

As *guanxi* economies grow and become more complex, however, the incremental costs of doing business shoot up. What worked with a hundred clients, a dozen suppliers, two creditors and one shareholder no longer works with thousands of all of these. So there comes a point, Messrs Li reckon, when the average cost of doing business in a *guanxi*-based system of governance exceeds that in rules-based systems. When this happens, companies and countries that rely on *guanxi* can no longer compete. Market forces initiate a transition to a rules-based system. This is probably the largest and riskiest step that countries and companies ever have to take.

Yet the danger of not taking it is even greater. Compare, for instance, the approach of securities regulators in China and the Philippines. In the early months of this year China's regulators were cracking down so ruthlessly on insider trading in its domestic stockmarkets that the markets were thrown into chaos and many investors, especially small ones, lost their savings.

By contrast, in the Philippines last year, when an ethnic-Chinese tycoon and crony of then-president Joseph Estrada was accused of insider trading, the presidential office put pressure on the stock exchange and the regulator to lay off. It seemed an easy way out, but the end-result was even more painful than in China. The investigators resigned, and the stock exchange shut down entirely at one point. When it re-opened, investors pulled their money out of the country and have not returned.

Transition requires political leadership. Visionary chief executives can set examples and lead the way in their own companies. But conflicts of interest arise, and bosses are only human. For Asia to achieve best

practice in its corporate sector, governments must therefore penalise bad practice by imposing fines and jail sentences.

But transition also requires a wholesale philosophical change. The governments of Singapore, Malaysia and China, for instance, should withdraw from the corporate sector so that companies are removed from the political arena. Ultimately, corporate governance and shareholder rights ring hollow without a genuine market for corporate control—in other words, hostile takeovers to remove incompetent or fraudulent managers, whether they are cosy with government or not.

Wanted: a Magna Carta

Nor is press freedom a luxury to be deferred to another day. There can be no transparency without an unfettered press. It was a brave journalist in Shanghai who blew the whistle on the fraud at China's securities firms. But correspondents are routinely minded by official "drivers" and "translators" in China, and any one of them will tell you that such scoops are not encouraged.

Inevitably, this raises the question of liberty in general. For many Asian leaders, this remains a non-subject. Singapore's senior minister, Lee Kuan Yew, has always regarded democracy as a western indulgence, and will cite his achievements in Singapore to prove his point. China's reply is equally well rehearsed: the Philippines, Thailand and Indonesia are democracies, and just look where that has got them. Imagine the insufferable tedium, says one top Chinese official, of having to travel to India and, sitting in the middle of the mess that it is, enduring the obligatory welcome to "the world's largest democracy". China's favourite comparison by far, of course, remains chaotic Russia.

But not all are so smug. Cao Siyuan, the controversial Beijing consultant, says that "economic reform cannot outpace political reform indefinitely." What has held back and disrupted the development of Asia in the past, as this survey has argued, has been the absence of rights for minorities and individuals. Fighting for them, therefore, is in the interest of the majority.

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Acknowledgements

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Offer to readers

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Let the bad times roll

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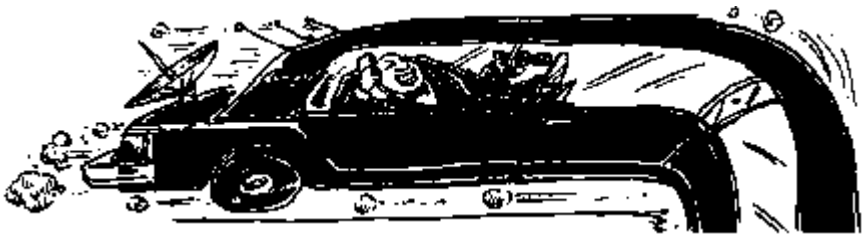
From The Economist print edition

For all the talk of flexibility and integrated supply-chain management, the economic downturn has caught many companies on the hop. What went wrong?



"IT'S the worst thing I've ever done in my life," admitted John Chambers, chief executive of Cisco Systems, after announcing big job cuts last month. "We went from over 65 miles an hour down to flat or negative growth in what, two months? I don't know many companies in the world that could do that."

Other versions of Mr Chambers's lament can be heard up and down Silicon Valley these days, and in most other parts of America too. Almost daily, some totem of the new economy admits to a thoroughly old-fashioned sense of bewilderment. Ed Zander, president of Sun Microsystems, confesses: "I have never seen an environment where capital spending has fallen off as dramatic and sudden as this in all the years I have been in the business." Carly Fiorina, at the helm of Hewlett-Packard, feels as if she is "navigating through the fog". This week Ariba, a big noise in the business-to-business business, announced glum profit numbers and layoffs, coupled with the standard complaint (by Bob Calderoni, the chief financial officer) that "the predictability of our business going forward is very limited."

Yet not so long ago, companies such as these thought that they had a better feel for the state of demand than ever before. They had fancy electronic links with their suppliers and boasted of the new flexibility that came with building to order, not for stock. Even so, managing in a downturn appears to be tougher than most of them expected.

What has gone wrong? Part of the problem is the sheer ferocity of the downturn, a mirror image of the over-inflation of last year's bubble. For the past two years, as Allen Delattre of Accenture, a consultancy, points out, high-tech companies had become accustomed to sales growth of 40% or so from one quarter to the next. The sheer momentum created by this would have made even a gentle slowdown difficult. In fact, both profit warnings and stockmarket declines are far more severe than in previous downturns.

Companies may still wonder whether they face a short bounce or a long slump. Shareholders are less hesitant. Faced with unforgiving investors, companies feel obliged to accompany every announcement of bad news with plans to cut jobs (see table). But they hedge their bets: many of the 400,000 job cuts announced in the first quarter may, in fact, merely be cuts in unfilled positions, according to Steve Patchel of Watson Wyatt, a human-resources consultancy. There are still 425,000 positions for which companies cannot find applicants with the right skills.

The news of job cuts affects confidence, however. And better information may, ironically, compress the corporate response. As Alan Greenspan of the Federal Reserve recently pointed out, business managers receive similar signals, and so "appear to be acting in far closer alignment with one another than in decades past." Mike Volpi, Cisco's chief strategy officer, says information about economic changes is much more quickly available than in the past. "Because of that, everything spiralled down much faster."

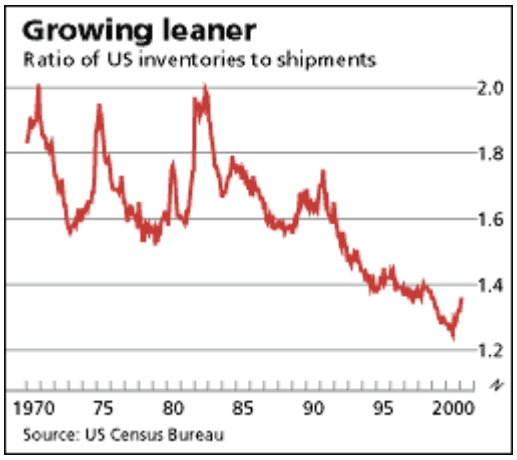
While better information may be compressing the response, it has not been good enough to predict the behaviour of buyers. And the supply chain, although leaner than it was in previous recessions (see chart), still has lots of inertia. At Flextronics, a giant contract manufacturer that makes hardware for high-tech firms, an emphasis on curbing costs means that materials may travel half-way round the world and back before a product is finished. That takes time. Some memory chips take 13 weeks to make, says Stacie Kilgore, a supply-chain analyst at Forrester Research. So build-to-order turns out to mean "build-till-almost-ready-for-an-order".

Crash diet
Large corporate layoffs announced in the past three months

General Electric	75,000*
DaimlerChrysler	26,000†
Procter & Gamble	22,000
Nortel Networks	21,150
Lucent	16,000
Motorola	11,000
WorldCom	10,000
Sara Lee	7,000
Delphi	7,000
J.C. Penney	5,300
Cisco Systems	5,000
Intel	5,000

*Over two years †Over three years
Sources: Company reports; press reports

Nor is it just in high-tech businesses that suppliers have been caught with too much inventory. In the car industry, for example, demand has dropped faster than companies expected. Worse, the fall comes after a boom that—unusually—combined soaring sales with falling prices and heavy discounting. The worst-hit suppliers have, in the words of one analyst, been "caught between the dog and the fire hydrant".



Uncomfortable though that position may be, the rise in the ratio of inventories to sales has so far been modest, compared with the wild swings of the 1970s and 1980s. That gives some hope that the overhang in inventories may be easier to deal with than it used to be.

Nonetheless, managing the recession will still be difficult for executives who have long since forgotten what the previous one felt like. In particular, they need to be careful about losing good staff. There may be a pause in the war for talent, but there is a lesson from continental Europe's recent experience with slow growth, says Roland Berger, head of a Munich-based consultancy. Companies that use the best of their surplus employees creatively are best placed for recovery. He points to the way that Siemens, a German engineering concern, benefited in the second half of the 1990s from investments in innovation in the first half.

Some American companies have had similar experiences. For example, Dixie-Narco, a subsidiary of Maytag that makes vending machines, hit a crisis when Coca-Cola, one of its largest customers, suddenly slashed orders. The company weathered the storm without layoffs, partly by reassigning redundant production workers to find ways to cut costs, improve quality and streamline production. As a result, says Anand Sharma of TBM Consulting, the company drew ahead of competitors that had made swingeing staff cuts.

In fact, observes Nancy Koehn of Harvard Business School, author of a new book on the history of branding, recessions act as filters, creating opportunities for deft managers. She cites the example of Estée Lauder, who founded her cosmetics company because she discovered during the bleak 1930s that women actually wanted to buy lipstick more when times were bad.

The most recent recession, of 1990-91, also provides examples of success born of adversity. Starbucks, a coffee chain, was founded in the early 1970s but spurted to its successful flotation in 1992 by applying the clear customer focus that a recession requires. Southwest Airlines, notes Ms Koehn, benefited from the reduction in competition that recession brings: the collapse of Midwest Airlines in 1991 gave it the chance to move into Chicago's Midway Airport, while its low-cost business model was perfect when travellers were strapped for cash. The moral is that companies that take advantage of the downturn, rather than merely muddling through, will be best placed to accelerate when the good times roll once more.

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Corporate expenses

The unkindest cuts of all

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WHEN Herbert Hainer took over as chief executive of Adidas-Salomon last month, one of his first actions was to cancel the free biscuits at the sporting-goods group's German headquarters. In New York, investment bankers at Schroder Salomon Smith Barney recently received a memo telling them not to use outside agencies to design the transparencies for their presentations to clients. They were also instructed to choose the wine at business lunches, to cancel magazine subscriptions and to use calling cards rather than hotel telephones. At Excite@home, sodas that were once free have cost 25 cents each since January; meanwhile, the Internet portal's weekly ice cream party has, tragically, become a fortnightly event.

As the world economy slows and corporate profits come under pressure, cutbacks are suddenly on the agenda. Nothing, it seems, is too petty to escape the notice of managers desperately trying to rein in their budgets. But are cuts like these really worth making?

No, argues Daniel Levine, a writer who until recently ran disgruntled.com, one of several popular employee "whinge sites", including faceintel.com, vault.com and fuckedcompany.com. "Petty cuts are foolish. They are merely symbolic, sending the message that everyone needs to be nervous," he says. "They kill morale without giving any bottom-line benefit."

That can certainly be the effect. A case in point is a recent and particularly heavy-handed internal memo (entitled "On the record") at PricewaterhouseCoopers about making personal telephone calls. This threatened Big Brother-like examination of individual phone records—even incoming calls—and was sensitively timed for Valentine's Day. The booby prize, however, goes to Edison International, a California utility caught in the state's power crisis, which is making its cleaning staff work in the dark wearing miner's lamps in an effort to save electricity.

Even superficial cuts, however, can save more cash than you might think. Schroder Salomon Smith Barney spent $2.7m on those transparencies in 2000. Morgan Stanley, a rival, may be saving a mere $38,000 a year by scrapping birthday cakes for its New York-based investment bankers, but Goldman Sachs, another big investment bank, is said to be saving $2.4m a year by getting rid of free bowls of fruit. These cuts are to some extent inspired by cost-saving measures in past downturns: during the previous recession, American Airlines apparently saved $100,000 by removing one olive from each salad served in first class.

When the frugality goes a little deeper, it can have a bigger impact still. A memo from Intel's chief executive, Craig Barrett, warned staff in February that the chip maker is aiming to slice 30% from its discretionary expenses by reducing travel, overtime, relocation and consulting costs—as well as by delaying the promise to provide all employees with a free home computer.

However trivial and annoying cuts such as these may seem, they are usually better than the alternative: layoffs. According to John Challenger of Challenger, Gray and Christmas, an outplacement firm, the current reduction of staff perks shows that companies are, by and large, acting with more sophistication than in the previous downturn. While under pressure from shareholders as never before, many firms are attacking indirect costs before resorting to mass sackings—not least because they have learned during the long boom times how hard it can be to attract, train and retain qualified workers. Ironically, that very competition for talent in a tight labour market, especially in America, means that there are now more perks to cut.

The passing of the boom's more new-fangled perks may be no bad thing. Concierge services, petsitting, nap rooms and the option to telecommute are really just sneaky new ways to get already overworked employees to toil even harder, says Jill Andresky Fraser, author of "White-Collar Sweatshop" (W.W. Norton, $26.95). "These perks are often illusory. They exist just for their publicity value," she says. "In reality, staff face resentment if they try to work from home or take family days. And free food, nap

rooms and home computers just keep people tied to their work." The idea that employees should actually be grateful for the removal or curtailment of their little perks and pleasures might seem far-fetched—but as the downturn bites, it is a consoling thought.

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The Executive Life affair

Pinault in a pickle

Apr 5th 2001
From The Economist print edition

ALREADY locked in a courtroom battle over ownership of Gucci, France's most controversial entrepreneur now faces another, potentially more damaging, legal tussle. Late last month, a judge in California threw out a motion by François Pinault to have a lawsuit against him for alleged fraud dismissed without going to trial.

Mr Pinault, who controls one of France's biggest retailing empires, has argued that the lawsuit, brought by insurance regulators in California, is groundless. If he loses the case, which should come to trial next year, he may have to pay back the profits, estimated by some to be in excess of $1 billion, that he made from his part in the alleged fraud. Even if he wins, he may be forced into some embarrassing admissions.

The regulators will try to force disclosure about the beneficial ownership of companies, resident in tax havens, that control around 25% of his empire. Mr Pinault told the insurance regulators in 1994 that he controlled these companies, but he has informed stockmarket regulators in America and France that he does not. If he now admits to beneficial ownership, he could be required to open up these companies' accounting records.

The lawsuit arose out of Mr Pinault's role in the takeover of Executive Life, a California insurance company. This firm went bust in 1991, when the market value of its junk-bond portfolio collapsed. Insurance regulators opted for a rescue package, put together by Crédit Lyonnais, a French bank. The bank made a cash offer for the junk-bond portfolio and arranged for a new insurance company, Aurora, to take over Executive Life's insurance contracts. Regulators were told that the consortium that was to own and manage Aurora would be independent of Crédit Lyonnais, as federal and state laws required.

A lawsuit for fraud was launched against Crédit Lyonnais in 1999 after regulators discovered secret agreements. These showed that members of the consortium of "independent" shareholders in Aurora were in fact fronts for Crédit Lyonnais. Mr Pinault and one of his companies, Artémis, were added to the lawsuit last year. The regulators allege that Mr Pinault was party to the fraud as buyer of, first, a large part of the junk-bond portfolio from Crédit Lyonnais and, later, the insurer. They believe that Mr Pinault had knowledge of the consortium's agreement to act as fronts; and that he joined a conspiracy of silence by keeping secret the fact that he was, in effect, really buying shares in Aurora from Crédit Lyonnais and not from members of the consortium.

Documentary evidence seen by *The Economist* strongly suggests that Mr Pinault had knowledge of the consortium's fronting role. First, in December 1992, when he bought part of Executive Life's junk-bond portfolio, Mr Pinault signed a binding agreement with Crédit Lyonnais under which he also acquired the bank's rights to Aurora. If he did not believe that the bank would have control over Aurora, it is hard to see why he would sign such an agreement.

Then there is the registered letter that Mr Pinault sent to a senior executive at the bank on March 31st 1993. It is clear from this that Mr Pinault believed that the agreed deal for him to buy Aurora was in jeopardy and that he had a right to financial recompense. Unless he believed that Crédit Lyonnais would pull the strings at Aurora, this was a strange request to make.

Shortly afterwards, Mr Pinault also asked Crédit Lyonnais to provide him with indemnity against legal challenges that might arise in California relating to the Executive Life deal. A clear inference is that Mr Pinault suspected that there was something untoward about the transaction. Otherwise, why ask for this protection?

Another fact strongly points to Mr Pinault's knowledge of the consortium's role. Copies of Crédit Lyonnais's fronting agreements with two members of the consortium were found at his offices in late 1998. According to lawyers for the insurance regulators, Mr Pinault has not yet explained precisely when or how these contracts came into his possession.

The Economist has seen a filing made by Mr Pinault with the insurance regulators in 1994. This does not disclose the existence of the agreement he signed in 1992, under which he obtained Crédit Lyonnais's rights to acquire Aurora. Furthermore, it states that Artémis was acquiring shares in Aurora directly from one of the fronts, and made no reference to the fronting agreement concluded between Crédit Lyonnais and the consortium member. The regulators say these crucial omissions ensured that the fronting scheme, which had been hidden from them by Crédit Lyonnais, stayed secret. Mr Pinault insists that all the filings he made with the insurance regulators were accurate.

However, it seems that Mr Pinault does have a strong case to answer in California. A crucial legal issue will be how a reasonable person should have responded if he knew, or ought to have known, that the Executive Life deal was in any way tainted, as it seemed to be, for example by the fronting agreements. With knowledge of these agreements, a reasonable person would surely have made further inquiries into why they were needed, and then realised that the entire scheme had an illicit purpose. But not Mr Pinault, apparently.

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Going hostile

Apr 5th 2001 | FRANKFURT
From The Economist print edition

A YEAR ago, Klaus Esser was reaping praise. Although he had failed to fend off a hostile bid by Britain's Vodafone AirTouch for Mannesmann, the German firm he then ran, he had fought fairly, eschewing nationalistic, "barbed-wire" tactics. The result was not only the priciest merger ever, but also the first hostile takeover of a German company by foreigners.

Now Mr Esser is reaping lawsuits. On April 4th, Jean-Marie Messier, chairman of Vivendi Universal, a media group, said that he would take action for defamation over an interview with Mr Esser in that day's *Financial Times*. This follows a German prosecutor's decision to investigate claims that, when Mr Esser finally threw in the towel against Vodafone, he was influenced by the prospect of DM60m ($30m) in severance pay. Mr Esser has denied this.

Mr Messier's company played a key part in the takeover battle. Before Vodafone made its offer in November 1999, Vivendi and Mannesmann were discussing a friendly merger. After the bid, Vivendi was looking both ways: even as it was negotiating with Mannesmann, it was being wooed into a joint venture with Vodafone. When Vivendi plumped for Vodafone at the end of January 2000, Mr Esser knew the game was up.

Then the sniping began. In a book, Mr Messier blamed Mr Esser for the failure of the Mannesmann-Vivendi merger, claiming that the German had tried at the last minute to renegotiate the composition of the putative board. Mr Esser says the matter was still open, and that Mr Messier should not have treated Vodafone as an alternative to Mannesmann. Mr Messier's behaviour was "highly indecent and dishonourable", he told the FT, prompting the Frenchman to call his lawyers.

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Face value

Hemmed in at home

Apr 5th 2001
From The Economist print edition

Rod Eddington is turning round British Airways with remarkably little fuss. But its growth is hampered by overcrowded Heathrow airport

Get article background

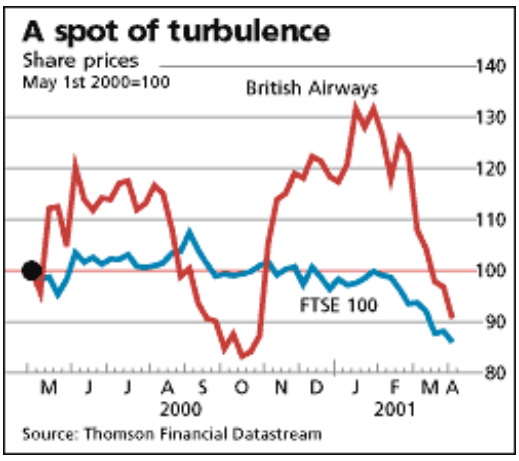
STRIKES and strife are in the air on both sides of the Atlantic. Cabin attendants at United Airlines, mechanics at Northwest and sundry staff at American Airlines and Delta are all in dispute with their employers. Americans are braced for their third horrendous summer of air travel in a row. In Europe, Lufthansa pilots are soon to vote on whether to strike, while Swissair, which owns 49.5% of troubled Sabena, is nursing huge losses.

Notably absent from this list of ailing airlines is a carrier that last year was in more trouble than any other: British Airways. In the year to March 2000, BA made its first loss since privatisation. Its chief executive, Bob Ayling, was asked to resign, the day after he had opened BA's London Eye ferris wheel, which has since become a hugely successful global landmark.

Today BA seems to be on its way back up. It has returned to profit, its snazzy business cabins are full as tired travellers rush for its flat-bed seats, and it has yet to notice any decline in its traffic from America, its biggest market outside Britain. The airline has even managed to cut over 1,000 jobs at Gatwick airport, as it tries to stem losses in its European business, without a hint of industrial unrest. Little more than a year ago, such a cutback would have brought disgruntled employees out on strike.

One reason why it has not this time is BA's new chief executive, Rod Eddington, an Australian who taught nuclear physics at Oxford University before spending 20 years in the airline business, first running Cathay Pacific, then turning round loss-making Ansett in his home country. In May 2000, he succeeded Mr Ayling, a smooth ex-lawyer with impeccable connections to Britain's Labour government but an uncanny ability to rub his staff up the wrong way. (Discussions with Mr Ayling would either be extremely brief or full of long pauses as he searched for all-encompassing theories.) Under Mr Ayling, morale slumped, customers grew fed up with grumpy staff and business suffered. Many of the necessary changes he sought were made far harder to implement by the climate of suspicion he helped to create.

Mr Eddington could not be more different. He is direct, and takes a pragmatic view of the job. He likes to get on with those around him: when he worked in East Asia, he took the trouble to learn Japanese and some Cantonese. His no-nonsense approach has won the confidence of his staff. Further, Mr Eddington has had the sense to keep the best of Mr Ayling's legacy, to junk his mistakes and to tackle remaining obstacles head on. Thus he has continued the shrinking of capacity started two years ago, leaving BA to concentrate on premium customers flying "point to point" rather than filling jumbo jets with low-fare transfer passengers. Unlike his predecessor, though, he takes care not to dismiss budget travellers out of hand. "Today's backpackers are tomorrow's investment bankers," he says.



Although he is sticking largely to Mr Ayling's strategy, his approach is more flexible. BA's low-fare offshoot, Go, founded by Mr Ayling to compete with low-cost carriers such as EasyJet and Ryanair, is expected be sold in the next few days to 3i, a private-equity group. Mr Eddington has scrapped plans to make Gatwick a second hub airport, instead turning it into a short-haul airport serving passengers in southern England. Many of

Gatwick's long-haul routes have been moved back to Heathrow. Meanwhile, loss-making European routes have been pruned.

Growing pains

Cutting out unprofitable routes will not, however, be enough to restore BA's fortunes. Its base at Heathrow is bursting at the seams, with 64m passengers every year using an airport designed for 55m. Even if a controversial fifth terminal wins approval, it would take seven years to increase capacity to 80m passengers. Meanwhile, both Paris Charles de Gaulle and Frankfurt threaten to overtake Heathrow in passenger numbers. Air France, Lufthansa and KLM now bypass Heathrow by running feeder services from the English regions that connect with long-haul flights at their continental hubs.

BA's biggest rival is the Star alliance, built around Lufthansa and United. Star has 25% of the slots at Heathrow, now that BMI (formerly British Midland) has joined the grouping. One way to deal with this growing competition, BA had hoped, was to merge with KLM, but that deal fell foul of aeropolitics: the Dutch carrier needed to stay under national control to preserve its rights to international routes.

Another way round the limits to growth would be to bind BA ever closer into its own alliance with American Airlines, Cathay Pacific, Qantas and others, called oneworld. The biggest step would be the virtual merger of transatlantic operations with American. But to get that past regulators, BA would have to give up hundreds of slots at Heathrow, which Mr Eddington is reluctant to do. He says he is exploring ways of working more closely with American, short of a merger, and is trying once more to persuade regulators. But he does not sound very hopeful.

BA executives admit that the airline has a "growth issue", which no amount of pampering premium travellers will address. The horrible truth facing BA is that, like Marks & Spencer, another British corporate icon, its glory days may be over. The only difference, say critics, is that, whereas the retailer's wounds were self-inflicted, BA's are mostly down to external factors. The airline's emergence as the world's most profitable airline in the mid-1990s, a decade after privatisation, may simply have been a phase in the industry's development.

Even restored to health, BA will be lucky to have made £200m ($295m) before tax in the year just ended (well below the £640m it made at its peak). If Europe's national ownership rules could be scrapped, it could acquire, say, KLM and form an airline giant. But for the foreseeable future, Mr Eddington's aircraft—and his ambitions—will be delayed at Heathrow.

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Asian retailing

A hyper market

Apr 5th 2001 | BANGKOK AND HONG KONG
From The Economist print edition

TO GET a feel for what is happening to retailing in Asia, take a visit to Rama IV, a busy thoroughfare in Bangkok. Alongside a putrid canal, shoppers jostle among stalls, haggling for the fresh produce being unloaded throughout the day from trolleys. This is Bangkok's oldest "wet market", and it is how Asians have shopped for centuries.

Then walk a few minutes up the road, to another world. Shoppers amble through spacious, air-conditioned aisles in halls the size of large warehouses, perusing the price labels on Thai silks, bicycles, furniture and food. This is one of two hypermarkets that have opened in the past few months on opposite sides of Rama IV. Betting that this is how Asians will want to shop in future, Tesco, a British retailer, and Carrefour, a French rival, were racing each other to open their stores first. In the end, it was a tie.

Asian retailing is being transformed by two changes. The first is the move from wet markets and small shops to giant hypermarkets. The second is the invasion of western multinationals with the skills, technology and culture to run megastores.

A decade ago, Asian retailing was a local business run by locals. Today it is on the verge of becoming an international business dominated by foreigners. Indeed, western entrants are now less concerned with local competition than with each other. Faster than anybody could have guessed, says Joe Lobbato, a retailing expert at Accenture, a consultancy, the market is leapfrogging "from zero to great sophistication".

Besides the obvious advantage, in such sweltering places, of air conditioning—for both the shopper and the produce—the convenience of "all under one roof" appeals to Asians as much as to everybody else. Asians are more price-conscious than western shoppers, because they are poorer, so the discount stores must at least match the wet markets on price. But as long as they do, they should win.

The first to realise this opportunity, in the mid-1990s, was Carrefour. America's Wal-Mart, and other European giants such as Royal Ahold, Makro, Casino and Tesco soon followed. At first, it appeared that they would barely have to break sweat. Not only was there little direct domestic competition to begin with, but those tycoons that were established suffered badly from the Asian financial collapse of 1997-98 and, in most cases, agreed to sell out. Tesco, for instance, bought a leading chain of stores from Charoen Pokphand, the biggest conglomerate in Thailand.

Even in countries that were less affected by the crisis, foreigners did well. After less than six years, Carrefour is already the third-largest retailer in China, and Wal-Mart the ninth-largest. In a market so burdened by red tape that even many local operators find it difficult to cope, this is quite an achievement.

The multinationals make up for their lack of local connections with superior logistics networks. Unlike local retailers, they have centralised purchasing and the resources to set up their own distribution networks from scratch. Most of their produce is sourced locally—and thus cheaply—and local suppliers prefer the western chains, which promise to put their goods on shelves throughout the country, or even across Asia.

It has not been all smooth sailing, however. In some markets, entrenched firms are all but unassailable. For instance, Carrefour recently pulled out of Hong Kong, where retailing is in the grip of a near-duopoly between Jardine Matheson, a trading house that once dominated the local economy, and Li Ka-shing, a Chinese tycoon who does so today. The Philippines is problematic for other reasons. For 46 years, it has banned foreign competition in retailing, and though it is now opening up, political turmoil makes entry unattractive. Casino, Carrefour and Pinault-Printemps-Redoute have recently walked away from deals in the Philippines.

There are also concerns that competition among multinationals will intensify to the point that returns dwindle. At first glance, this should not be an issue. France, Thailand and South Korea, for instance, have roughly similar populations. But France has 1,100 hypermarkets, whereas Thailand has only 77, and South Korea 96. Yet the multinationals are planning to open so many stores—often in the same locations—that the pavement is getting crowded. Hoping to beat each other to customers, they are already waging price wars.

So far, the unofficial winner appears to be Tesco. This is something of a surprise, because the odds a few years ago were on Carrefour, as the first mover. The French firm, it appears, did not make any single big mistake, but several small ones. Morgan Stanley, an investment bank, recently compared hypermarkets throughout the region and found that Carrefour displays a peculiar knack for putting its outlets in the wrong places and making its offerings “too French”.

Similar problems have also held back Royal Ahold, which recently scaled back its expansion plans in Asia, and Wal-Mart, which at one point tried to sell clothes to the Chinese in rather too generous American sizes. The lesson appears to be that Asians may indeed be drawn to trendy foreign names, wide aisles and air conditioning; but they also demand a local touch.

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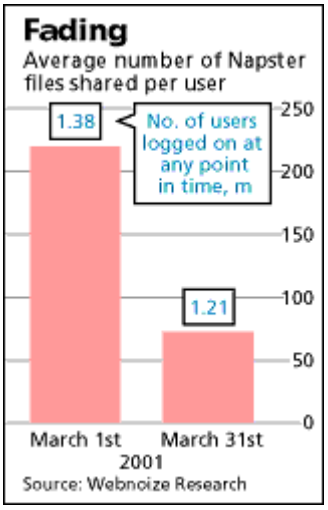
Digital copyright

Going straight

Apr 5th 2001 | SAN FRANCISCO
From The Economist print edition

With Napster, online music came to symbolise the end of copyright in the digital realm. But rights holders are fighting back

Get article background



KEEPING on the right side of the law has never been an attractive proposition for fans of online music—as followers of Napster, a free file-swapping service, can attest. Soon, however, it may be easier to go legit. On April 2nd, RealNetworks, a software firm, and three big record labels—Warner Music, Bertelsmann Music Group (BMG) and EMI—announced a joint venture called MusicNet that, they say, will make it possible to create all sorts of paid music-subscription services. Sony and Universal, the other two big labels, are planning a similar offering, to be called Duet. And in July, Napster will turn itself into a "secure membership-based service", with Bertelsmann's help.

The fate of these services will determine not just the future of the music industry, but also that of the underlying technology. All these offerings will include a "copy protection" scheme that limits what consumers can do with the files they download. Tracks shared on the new Napster service, for example, will play only on the PC of the user who has downloaded them. Online music, which has hitherto symbolised the end of copyright in the online world, could come to embody the opposite.

At first sight, this may seem to be a good thing. After all, owners of intellectual property should be able to protect their wares and charge for them. But there are risks. The trend towards restricting access could ultimately curtail some important existing rights, such as making copies for personal use.

It is easy to see why content owners want to limit digital copying. In the early 1980s, the record industry decided not to encrypt CDs. That is why it is so easy to copy tracks from a CD, convert them into MP3 format and make them available via Napster. Unsurprisingly, content producers and the consumer-electronics industry did not repeat this mistake with Digital Video Discs (DVDs). Data on DVDs are encrypted using a technology called the Content Scrambling System, or CSS.

New kinds of storage media, such as memory cards and minidiscs, will also soon come equipped with a digital lock. Intel, IBM, Matsushita and Toshiba have jointly developed technology called Content Protection for Recordable Media (CPRM) that can be used to ensure that a copy of a music file plays only on the devices of the file's rightful owner.

Making new storage media secure is relatively easy. It is harder to make existing devices safe—and, in particular, the PC. That is why the entertainment industry is putting pressure on PC makers to tame their products. The manufacturers are yielding, at least partially. Take the Trusted Computing Platform Alliance, formed in late 1999 by Compaq, Hewlett-Packard, IBM and Microsoft. Its main goal is to make e-commerce transactions more secure, but the technology could eventually be used to protect copyright. Critics worry also that CPRM will one day be used to stop PC users from making copies of music files on their hard drives.

Software firms, meanwhile, see copy protection as an opportunity. Microsoft, which this week launched a website called MSN Music, wants its technology to become the standard for secure online music. The latest versions of its Windows operating system come with a technology called Secure Audio Path, which can keep an audio signal encrypted until the moment it is played by a PC's sound card, so that users cannot capture the bits and make illegal copies. Windows now comes bundled with Microsoft's Media Player, which includes a "digital rights management" system that allows content owners to specify such things as how often files can be opened and when they expire. IBM and Intertrust offer stand-alone versions of the same technology.

Bruce Schneier, chief technology officer of Counterpane, an Internet security firm, argues that such ventures will fail because they contradict the “natural law” of the Internet, which states that bits are inherently easy to copy. With enough effort, he says, any copy protection scheme can be broken—even those embedded in hardware.

It is true that copy protection schemes have, for the most part, been no match for hackers. The CSS was broken in November 1999 after one DVD maker failed to scramble its decryption key. Even without that slip-up, the CSS appears weak. Students recently wrote a program with only seven lines that breaks the encryption of a DVD.

Fighting hackers, however, is easy compared with the task of persuading consumers to use encryption technology. Most audio gear sold with copy protection has flopped. The most recent failures have been MP3 players, such as Sony’s Vaio Music Clip, built to the specifications of the Secure Digital Music Initiative, a multi-industry effort to develop a standard to stop CD piracy. The complex copy protection on these devices—as with other anti-piracy schemes—makes them awkward to use.

Might all this change with the MusicNet initiative announced this week? Although details are still sketchy, the new firm could become a platform for all kinds of new business models. It intends to become the leading wholesaler for online music, licensing its service to other firms seeking to sell subscriptions, and leaving the packaging and pricing to them. So far, AOL Time Warner and RealNetworks have signed up. Others are expected to follow soon, including Napster once it has gone legal in July.

If everything goes to plan, MusicNet could allow the music industry to move forward at last, says Eric Scheirer of Forrester Research. Yet the success of music subscription services is by no means guaranteed. Although more than two-thirds of Napster’s 66m registered users say they will pay, experts doubt that they mean it. Instead, many will switch to free alternatives such as Gnutella and its variants, which are less easy to scale up than Napster but are also harder to shut down—and are getting easier to use.

The entertainment industry, meanwhile, is using all legal means to ensure that devices with certain capabilities do not reach the market. To produce a DVD player, for instance, firms now need a licence from the DVD Copy Control Association, which specifies what functions are permitted. New DVD drives that come with Apple G4 computers can record home movies, but cannot make perfectly legal copies of TV programmes or Internet videos.

The industry’s most powerful legal weapon in the United States is the Digital Millennium Copyright Act. This legislation, enacted in 1998, makes it illegal to reverse-engineer copy protection schemes. Last August, a New York judge ruled against 2600, a hacker magazine and website, saying that it could not even post links to sites that allow computers running the Linux operating system to play copy-protected DVDs.

The case shows what is perhaps the worst side-effect of the entertainment industry’s strategy: restrictions on free speech. Web links to the offending software and the program itself are arguably a form of speech protected by the First Amendment. The Digital Millennium Copyright Act could also inhibit innovation, argue its critics. It is, for instance, common for cryptographers to crack protection technologies in order to improve them. Some critics go even further. To them, it is philosophically wrong to set restraints on technology that eliminates scarcity, simply so as to benefit those who profit from that scarcity. But try telling that to the suits at Sony or Warner, man.

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Bounty hunters

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From The Economist print edition

NAPSTER and the threat to copyright online have received so much attention recently that another, equally important controversy over intellectual property has been sidelined. This concerns the threat that patents for Internet "business methods"—such as Priceline's reverse auction and Amazon's one-click ordering system—might pose to innovation online.

Charles Cella, a lawyer who once helped dotcoms to file for such patents, worries about this threat. So he has started an online service that, he hopes, will remove much of its sting. The company, called BountyQuest, busts patents by finding "prior art"—proof that the invention they protect is nothing new. Mr Cella has even persuaded Amazon's boss, Jeff Bezos, to invest in his start-up.

BountyQuest's business method—for which, ironically, Mr Cella has filed a patent—is straightforward. Firms that want to challenge a patent post a bounty of at least $10,000 on BountyQuest's website and pay a posting fee of $2,500. Individuals can then submit evidence of prior art. If they can prove that a patent is not new, they will collect the bounty (and BountyQuest collects an additional 40% of that sum in fees).

Although this sounds expensive, it is cheap compared with the alternative. Finding prior art in the traditional, offline way is often very costly, not least in researchers. Online bounty postings are passed around by e-mail and can easily end up in the in-box of somebody who has the immediate knowledge to bust a patent.

Since its launch in October, the service has completed 30 bounty hunts, ranging from $10,000 (a method for decreasing human appetite) to $50,000 (a petrol additive to reduce car emissions). In half a dozen cases, the money was paid out. One recipient was Brian Shuster, a digital porn mogul. He proved that he had run a firm that serves up banner ads to other websites before DoubleClick, the leading online advertising firm, filed for a patent claiming rights to the same technology.

Yet BountyQuest could not debunk one of the best-known (and most criticised) patents on the web: Amazon's one-click shopping. Although three submissions came close, they could not quite match all the claims of the patent. Nevertheless, Tim O'Reilly, a critic of business-method patents who had posted the $10,000 bounty, decided to split it between the three submitters anyway.

This points to a problem in BountyQuest's model: deciding whether a patent-buster deserves the bounty. Providing information that puts a patent in doubt does not automatically invalidate the patent—that is up to the courts. Conversely, surviving a bounty hunt unscathed does not necessarily make a patent rock-solid, as the case of Amazon shows. In 1999, the company filed a lawsuit against Barnes & Noble (B&N), a rival bookseller, to stop it using an online-ordering procedure similar to its own. In February, an American court refused to order B&N to stop using the procedure. Amazon's competitor, the judges argued, was likely to prevail in the patent trial, scheduled for September.

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Recycling

Remade in Japan

Apr 5th 2001 | OSAKA
From The Economist print edition

IT DOES not look good for the patches of greenery still left in Japan. On April 1st, a new law went into effect requiring owners of discarded refrigerators, televisions, air conditioners and washing machines to pay as much as ¥7,600 ($61) to have their used goods taken away and recycled. The government says the law puts Japan in the vanguard of environmentally friendly countries. Critics say that, by caving in to the business lobby, Japan has made a bad situation worse. They say the country is about to disappear under a mountain of rusting metal as consumers avoid the fees by dumping their appliances illegally.

As usual, the main bone of contention has been the question of who bears the cost. As Japanese government officials point out, in theory consumers eventually always pay recycling costs, whether they are billed explicitly, or via the cost of new appliances. But who gets billed first makes a big difference to economic incentives. If producers directly bear the cost of recycling, they are more likely to want to drive down costs by investing in recycling technology and developing appliances that are easy to recycle. Partly for this reason, the handful of countries that have already introduced recycling programmes for electrical goods, such as the Netherlands and Sweden, have all chosen to make producers pay. By charging consumers, Japan is taking the opposite path.

This, says the government, will have several benefits. It will encourage people to use their machines for longer. It will instil in consumers a sense of responsibility about the environmental cost of their consumption. And it will mean that the 300m appliances already in use in Japan can also be covered by the new law.

The big electrical-appliance makers, meanwhile, have not been treated quite so favourably as it appears at first. In theory, they are free to set whatever recycling charges they like, so long as these fees do not exceed costs by too much. The industry has organised itself into two groups, one led by Matsushita, the other by Hitachi. But consumer groups and local governments, which must clean up illegally dumped rubbish, leant heavily on the appliance makers. At their published rates, the companies are unlikely ever to cover their costs. Tokyo's metropolitan government, for instance, has calculated that it spends ¥15,800 breaking up and burying a fridge. The appliance makers are charging just ¥4,600 to recycle one.

As a result, Japan may, for once, have ended up with the best of all worlds. Consumers will hang on to their machines for longer. Producers will hope to lose a bit less money in future by making goods out of fewer, more easily reusable components.

Matsushita, meanwhile, at least has the comfort of knowing that its competitors are suffering more than it is. Matsushita's consortium chose to use existing recycling plants, rather than build new ones. The Hitachi group built 13 new sites, at great cost. Matsushita announced its super-low recycling charges first. Desperate not to lose custom, Hitachi's consortium reluctantly matched it, yen for yen.

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Oh no, Kyoto

Apr 5th 2001 | WASHINGTON, DC
From The Economist print edition

George Bush has thrown the decade-long effort to finalise the UN treaty on climate change into chaos. Can the treaty survive—and should it?

THE Kyoto Protocol, which binds industrialised countries to cut their emissions of greenhouse gases, was signed with much fanfare in 1997. For the United States, the deal was done by Vice-President Al Gore, who could fairly claim to have been one of the first public figures to focus attention on the dangers of global warming. Now, three years on, nearly a decade after the first UN treaty on global warming was signed, the protocol seems to have been dealt a lethal blow—and it was wielded by the man who defeated Mr Gore for the American presidency, George Bush.

AP

Get used to it

In truth, the protocol was already in deep trouble even before Mr Bush took office. The most recent round of negotiations over the implementation of Kyoto, held in The Hague last November,ended in disarray. The EU had refused to accept the American arguments that the Kyoto targets should be met through the use of more flexible mechanisms, notably the free trading of emission rights (including trading between countries) and the claiming of credit for forest and agricultural "sinks" that absorb carbon dioxide, the principal greenhouse gas. Some European ministers made it clear that they wanted Americans to feel some economic pain more than they wanted a workable agreement. Unsurprisingly, the Americans made it equally clear that they could not possibly implement Kyoto as it stood, for the cuts it required would be far too swingeing.

Mr Bush has now dropped two big bombshells, which may conceivably kill Kyoto altogether. Last month, to the embarrassment of Christie Whitman, head of the Environmental Protection Agency, and other top officials, he abruptly announced a U-turn on a crucial aspect of his domestic policy on climate change: a campaign pledge to regulate CO_2 through domestic environmental laws. And last week, he made it clear that his long-stated opposition to the Kyoto targets was not open to post-election persuasion. Some of his aides have flatly declared that the Kyoto agreement is dead.

Mr Bush's actions sparked a ferocious storm of criticism from every corner of the world, from Europe to Japan, and from Canada to China. Much of this was mere posturing, with environment ministers claiming to be shocked, shocked by a state of affairs they already understood. In addition, admittedly, there was a layer of genuine surprise at the administration's clumsy handling of it all. One American energy boss, a veteran observer of climate-change diplomacy, said he was amazed by "the manner and tone of how all this has been handled: it was inexperienced and immature."

AP

A tree-lined sink

The Europeans were only too happy to take the moral high ground. Yet, as their blindly rigid approach in The Hague showed, their position was hardly more tenable than that of the Americans. Quite fortuitously, two EU member countries are reasonably close to their Kyoto targets—Britain, thanks to its dash to gas in electricity generation, and Germany, thanks to the closure of much of East Germany's polluting industries. But the rest of the EU is hardly more likely to meet the Kyoto targets than is America. Mr Bush's apparent torpedoing of the deal could well have let hypocritical Europeans off the hook.

The dialogue between the EU and the Americans remains highly strained. After a curt reception of a delegation led by Margaret Wallstrom, the European environment commissioner, this week, Ms Whitman

issued a curious statement that captures the Kafkaesque quality of current American thinking. She starts on a seemingly cheerful note: “I continue to be as optimistic as the president.” She then goes on to reiterate Mr Bush’s hard line: “the Kyoto Protocol is unfair to the United States and to other industrialised nations because it exempts 80% of the world from compliance. That is why the United States Senate voted 95-0, to warn against sending the Senate a treaty that could damage the economy.” But she concludes by offering some hope: “Global climate change is a serious issue that this administration is committed to addressing by working closely with our friends and allies.”

Clear as mud

This statement has left everybody concerned with climate change scratching their heads and wondering whether the Kyoto treaty is really dead or not. There is a still more profound issue at stake, argues Maurice Strong, an environmentalist who was in charge of the earth summit in Rio de Janeiro in 1992. It was at that gathering that the then American president, Mr Bush’s father, signed the Framework Convention on Climate Change, the landmark treaty that launched the process that led to Kyoto.

Mr Strong argues that the younger Mr Bush’s attack on Kyoto could mean one of two things. Perhaps the president rejects the entire Rio process of international engagement on climate change. Alternatively, Mr Bush may object chiefly to the details of the Kyoto blueprint—the specific bundle of emissions targets and timetables agreed in 1997 in that Japanese city. If what Mr Bush opposes is the first, Mr Strong thinks that this “will be not just a setback, but an immense tragedy.” But if Mr Bush means the second, and if he comes up with some innovative counter-proposals, then the president might have provided a much-needed shock that revives the troubled treaty.

Working out what Mr Bush really means, and whether he will be the scourge or the saviour of the global environment, depends greatly on understanding the reasons for his opposition to Kyoto. This would be an easier task if Mr Bush had announced his policy in, say, a thoughtful speech on the matter. He has not, and his aides say that he will not do so until a cabinet-level panel completes an exhaustive review of the options.

However, the administration has already cited several arguments for opposing proposed action on climate change. It cites uncertainties about the science, the lack of participation of poor countries, the economic burden imposed on the United States and the political impossibility of getting the Kyoto treaty ratified in the Senate. All four of these warrant a closer look.

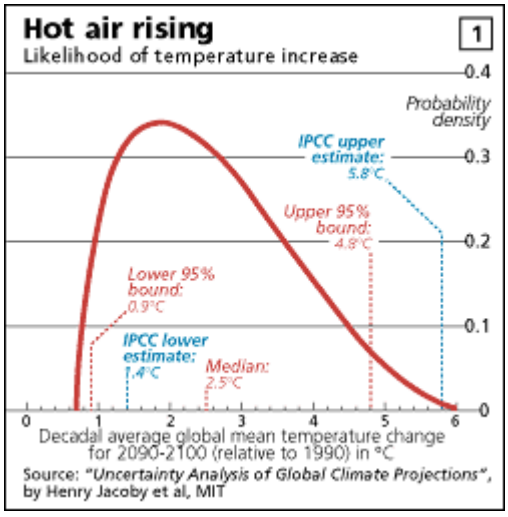
The alleged uncertainties of climate science are not a justification for Mr Bush’s actions. It is notable that even such heavyweight companies as Ford, BP and Royal Dutch/Shell, all of which opposed Kyoto, have since shifted their positions towards supporting its general aims, if not its specific targets. This is because they recognise that the overwhelming consensus among the climate scientists is that global warming is real, that its effects will eventually be damaging or even catastrophic, and that the evidence of man’s role in it is strong enough to warrant some action now.

The chief authority on this matter is the UN’s Inter-governmental Panel on Climate Change, which includes most of the world’s leading climate scientists. In the group’s latest and most alarming assessment, it said that the earth could warm up by between 1.4°C and 5.8°C over the next century. Sceptics have tried to rubbish this prediction, pointing out that the IPCC gives no indication of relative probabilities for that range. Now, a team of (comparatively sceptical) experts at the Massachusetts Institute of Technology led by Henry Jacoby has completed that elaborate number-crunching exercise (see chart 1). By their reckoning, the median rise in temperature that the world can expect, if no action is taken, is a troubling 2.5°C.

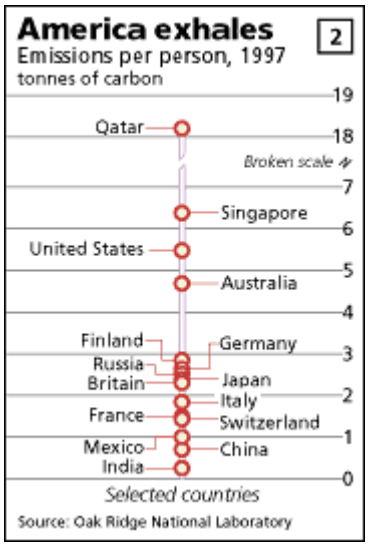
The second argument put forth by Mr Bush’s team is that developing countries such as India and China are not required to cut emissions, and so get a free ride while America suffers economic hardship. Under the Kyoto pact, only industrialised countries are required to cut their emissions of greenhouse gases during the first “commitment period”, to an average of about 5% below their 1990 levels by the end of this decade.

But does this mean that poor countries are getting off scot-free? It is true that China and India are already big emitters of greenhouse gases, and in a few decades may even be the world’s biggest.

Today, however, their contribution pales besides America's (see chart 2). It was the rich world that created today's problem by emitting greenhouse gases while industrialising over the past century; it is only fair, goes the argument, that rich countries act first to curb emissions. The Kyoto process envisages that poor countries will take on targets at a later stage.



That Mr Bush is challenging Kyoto on this point troubles many, because it suggests that he may have deeper philosophical problems with the Rio approach to climate change. His revelation that the poor are getting off scot-free rings hollow, for the notion of "common but differentiated" responsibilities is enshrined in the Rio treaty, which Mr Bush's father signed and which passed the American Senate unanimously. Even Republican insiders in the Senate say that there is room for compromise on this point—perhaps along the lines of a firmer commitment by developing countries that they will indeed sign up to Kyoto targets at a later stage.



A third objection from the new administration concerns cost. Some of this, too, is posturing. Claims by Mr Bush that America's "energy crisis" prevents it from taking action to curb emissions are bogus. There is no energy crisis in America, just a botched deregulation of electricity in California. Even so, the question of cost is paramount—and on this the Americans are more in the right than the Europeans.

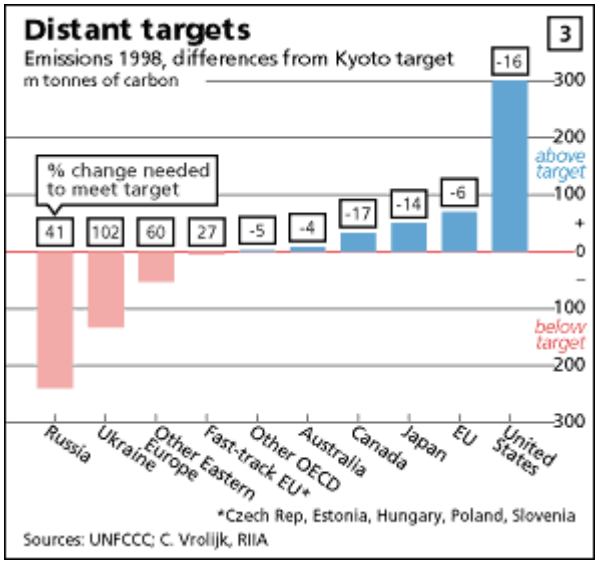
The costs of the Kyoto Protocol, as with everything else involving climate change, are not known with any precision. Economic analyses range from zero or even net gain to staggeringly high. The IPCC reckons that a modestly flexible treaty would reduce global GDP by between 0.1% and 1.1% in 2010. But most economists agree that, if the treaty is implemented in a more flexible way, to allow market forces more play and encourage innovation and investment in clean technologies, the cost can be substantially reduced. Such provisions are envisaged in the language of the Kyoto pact, and were the starting-point for the Clinton team negotiating in The Hague. But they fell foul of the Europeans' suspicions of the market. The EU delegation insisted on a variety of measures, such as restrictions on emissions trading, that would have made the deal more rigid and more costly than it had been to begin with.

As for the fourth point, about congressional politics, there is no doubt that the Senate was never going to ratify Kyoto as it stood. But it did ratify Rio, and Mr Bush may now be underestimating the degree of public concern about global warming.

Fixing Kyoto

The game has moved on, however, and if there is now to be any chance of rescuing and improving Kyoto, some big changes must be made to its provisions. Chief among these are targets and timetables, which are key determinants of the treaty's economic cost. That is because one of the chief attractions of Kyoto to the environmental lobby is also its biggest drawback: the fact that it calls for sharp reductions in emissions over a relatively short period of time. That was meant to have the pleasing effect of galvanising politicians, and jump-starting the century-long process of dealing with climate change seriously.

The trouble is that front-loading deep cuts makes them much more expensive to implement. And that problem has only become worse as the American economy has churned out emissions over the past decade of growth. As a result, America's emissions are already well above their baseline of 1990, and higher by an even greater margin than the target set for the end of the decade (see chart 3). Many European countries also have a tough road ahead—which some have no real intention of travelling—but for most the required cuts are not as savage as America's.



Though few politicians on either side of the Atlantic pay attention, economists argue that there is a better way to reduce the economic burden of Kyoto: to introduce a “safety valve”. David Victor of the Council on Foreign Relations, a think-tank in New York, worries that governments will learn the wrong lessons from the Kyoto saga: that the demise of the treaty is due merely to the ambition of its targets and lack of will in the United States. In a timely new book, “The Collapse of the Kyoto Protocol” (Princeton University Press, $19.99), he argues that, while those factors are undeniable, the real cause of the treaty’s collapse is the architecture of a pure “cap and trade” system, which allows ambitious targets but puts no limits on compliance costs.

A number of like-minded boffins agree that, since global warming is caused by the growing stock of greenhouse gases in the atmosphere (rather than any one year’s level of emissions), strict caps in the short term make little sense. The cost of meeting a specific emission target can be astronomical if, say, firms do not have enough time to adjust or if they have long-lived capital assets. Mr Victor argues that Kyoto must be amended with some safety valves (such as extra credits that a country could issue if costs of compliance skyrocket in a given year), to ensure the economic burden is supportable.

The end game

Will the shock that Mr Bush has given to the Kyoto deal result in the adoption of any such sensible proposals? Since even Mr Bush’s administration does not seem to know its own position on global warming, it is hard to say. The next few months will bring several opportunities for America and Europe to clash on this matter. Talks among several dozen environmental ministers are due later in April in New York. For that meeting, Jan Pronk (the Dutch environment minister who chaired the failed talks in The Hague last November) is preparing a robust new proposal that he hopes will bridge the ever-wider gulf between the EU and America. The Bush administration has also said America will still participate in the next round of the Kyoto process, due to be held in Bonn in mid-July. However, it is not clear that the taskforce now developing a new climate change policy will be finished by July—or what poor Ms Whitman will say in Bonn.

Given all this, several outcomes are possible. First, it is plausible that the entire Kyoto process may fall apart completely. This could happen suddenly at the Bonn gathering, or in painfully slow fashion thereafter. If the Europeans maintain their hostility to market approaches and continue their hypocritical attacks on Mr Bush, they could well push the talks off the rails.

Even more deadly, though, would be the revelation that Mr Bush’s opposition to Kyoto extends beyond targets and timetables to the entire Rio process. However, such a derailment seems unlikely, as public support for action on global warming is strong in both Europe and—say some recent opinion polls—even in America. There are signs that Mr Bush’s stridency on the Kyoto pact and his desire to open Alaska to oil exploration may be provoking a broader green backlash that could rally support in Congress for action on global warming.

Another possibility is that Europe forges ahead with the Kyoto treaty while America dawdles. Comments from Mr Bush’s national security adviser and others suggest the White House believes that Kyoto will die without the United States. Not so fast, say various outraged European officials. Sweden’s environment

minister, Kjell Larsson, insists that “the Kyoto Protocol will not fail just because the United States doesn’t join.”

Technically, he is right: the treaty can come into force if 55 of the signatories ratify it, including a big share of the polluters. In practice, that means the EU must persuade Russia and Japan to sign. Realistically, however, he might be talking nonsense. After all, any treaty that purports to address global warming without the support of the country with the biggest emissions, which also happens to be the world’s biggest polluter, is surely a farce.

Not necessarily, argues Michael Grubb of Britain’s Imperial College. He reckons that the only salvation for the process will come from bold, but measured, steps taken by the EU. He argues that Russia will ratify the treaty since it has much to gain from the sale of its plentiful stock of unused emissions. Japan is trickier, since it is even less likely to meet its targets than Europe; that is why the Japanese are as keen on market mechanisms and trading as was the previous American administration. In the end, though, Mr Grubb argues that Japan will not allow its refusal to ratify to provide the nail in the coffin for a treaty bearing the name Kyoto. By the time the next earth summit takes place, in September 2002, in Johannesburg, he reckons it may be in force, even without America.

The key, he argues, is for Europe to do this not with bitterness, and certainly not in the rigid, moralistic and ultimately costly tone that it adopted in The Hague. Rather, he argues for Europe to pursue as flexible an interpretation as possible, so that Kyoto becomes potentially attractive to the United States. By forging ahead, he notes that Europe would also show that it is not merely posturing over Kyoto. This may help persuade poor countries to commit voluntarily to targets in future, which in turn may lure America back to the table.

The last option, of course, is that Mr Bush surprises everybody and comes up with a credible set of proposals that revives the Kyoto negotiations, either by the Bonn meeting, or more likely some time thereafter. To do that, however, he will probably need to come up with some serious domestic initiatives on climate change, so as to claw back some of the credibility and goodwill he has lost on this issue in recent weeks.

Such an outcome seems less fanciful when one considers that it is not only green groups, or even the ordinary punter, that wants action on climate change. Many of America’s biggest businesses, ranging from DuPont to United Technologies, and even to coal-fired utilities like AEP, support action on climate change and want regulatory certainty on the question of carbon. Those are the sorts of voices that Mr Bush should heed. One of Mr Bush’s top lieutenants this week even insisted that his boss would be a world leader on this issue. The ultimate irony of the past two weeks’ coruscating attacks on the American president is that he could yet turn out to be Kyoto’s saviour after all.

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Let the revolution begin

Apr 5th 2001 | FRANKFURT
From The Economist print edition

Allianz's proposed takeover of Dresdner Bank will have big ramifications. Our first story looks at how it fits into the restructuring of Germany's finance industry; the second assesses other experiments in bancassurance

LAST weekend, Allianz, a giant insurer, made a friendly bid for Germany's third-biggest bank, Dresdner, of which it already owns more than 20%. The merger, assuming it goes ahead, will do more than create Germany's largest listed company. For Allianz is taking a big stride into *Allfinanz*, the concept of supplying insurance, banking and asset management under one roof. The deal will also disentangle some of the mesh of cross-shareholdings in German finance.

AP

Schulte-Noelle and Fahrholz: partners for a while

For some time, Allianz has believed that it is not enough to be an insurer selling mainly through agents, even with 17m clients in Germany alone. In the past couple of years, the Munich-based company has set up an asset-management division and bought two American asset-management firms. Moreover, its policies have long been sold in the branches of various banks. But Henning Schulte-Noelle, Allianz's boss, said this week that his company was "under-represented" in the German asset-management market, and that it had too little capacity for selling through banks. By buying Dresdner, Allianz will acquire two channels for its products: a retail bank and DIT, a Dresdner subsidiary that is Germany's fourth-biggest fund manager.

A prime reason for Mr Schulte-Noelle's belief in *Allfinanz* is that Germans are now less inclined to stick to savings accounts and life insurance, and are keener to buy shares, especially through mutual funds. This is expected to continue, not least because the government wants to persuade Germans to save more for their own pensions, and to rely less on the state.

A swap of shareholdings between Allianz and Munich Re, the world's biggest reinsurance firm and Germany's second-biggest primary insurer, is also part of the deal, and it will reinforce the shift to *Allfinanz*. Munich Re will acquire Allianz's stake in HypoVereinsbank, the country's second-biggest bank, and hand its holding in Dresdner to Allianz.

When the music stops, Munich Re expects to own about one-quarter of HypoVereinsbank, a big mortgage lender (see article), compared with its current 5%, creating, in effect, another *Allfinanz* grouping. Allianz will also become the sole owner of Allianz Lebensversicherung, a life-insurance company of which it currently owns just over half.

Small change

In some respects, however, the merger will change little. Its impact on Dresdner, for a start, is minimal. The bank will still have the same boss, Bernd Fahrholz, who will run it from Frankfurt, not Munich. Mr Fahrholz will continue with his plan—set out after the acrimonious break-up of his bank's attempt to merge with Deutsche Bank last spring—of reducing the bank's branch network from 1,150 to 850 by 2002. Dresdner's investment-banking arm, Dresdner Kleinwort Wasserstein (DrKW), will be kept, although a flotation is likely in a few years. It is wise to keep DrKW sweet: it was a quarrel over the future of Dresdner's investment bankers that brought down the Deutsche-Dresdner deal.

More important, perhaps, the deal will do little to hasten the long-awaited consolidation of Germany's retail financial-services industry. Granted, it puts pressure on Dresdner's rivals. Like Mr Schulte-Noelle, Deutsche's boss, Rolf Breuer, is a believer in *Allfinanz*. However, he is still looking for a partnership with a big insurer, perhaps France's AXA. The smaller Commerzbank already has a link with Generali, an

Italian insurance company. Its small size, though, makes it a favourite for takeover.

The revolution, then, is yet to come. And with any pairing of Deutsche, Commerzbank or HypoVereinsbank hard to envisage, the likeliest source of change lies in the public and co-operative sectors. To non-Germans, the strength of these institutions often comes as a surprise. Over 50% of Germans' savings accounts are in the hands of the 563 *Sparkassen*, or savings banks, which are usually owned by municipalities. A further 30% are in about 1,800 co-operative banks. Germany's second-biggest fund manager by assets, DekaBank, is owned by the *Sparkassen*, and the third-biggest, Union Investment, by the co-operatives. In both 1999 and 2000, they each took in more money than the leader, Deutsche Bank's DWS.

The private banks often grumble that the *Sparkassen* have an unfair advantage. Because the public-sector banks are owned (and guaranteed) by municipalities, they can lend more cheaply than their private rivals. The same is true, mainly in corporate banking, of the 12 *Landesbanken*, which are owned by the *Land* (or state) governments and the regional savings-banks associations.

But change is now afoot. The European Commission has been fighting with the German federal and state governments over the guarantees enjoyed by the *Landesbanken* and the leading *Sparkassen*. The smaller savings banks are not in the firing line, because they have no cross-border business. But big changes at the *Landesbanken*, which act as clearers for them, would be sure to have a knock-on effect. In any event, the number of small savings banks and co-operatives is steadily being reduced by mergers.

Only a few months ago, they were set against any concession to the Commission. But now they are shifting their ground. Westdeutsche Landesbank, the largest *Landesbank* and Germany's fourth-biggest bank, has offered to split itself into "commercial" (but not privatised) and public-sector parts. The second-biggest state bank, Bayerische Landesbank, said last month that it might be restructured without guarantees.

Quite what the outcome of all this will be, no one can tell. But the upheaval in the public sector is likely to be as big and as important as anything going on among the private banks. Without state guarantees, the public-sector banks would look weaker, making some, in a rational world, candidates for takeover. Some of them might join forces: just conceivably, parts might eventually be taken over by private rivals.

Yet even then, the shake-up in German finance would not be complete, because it remains essentially domestic. Allianz is said to be mulling forays into America and Japan. But the key arena is Europe. In nine months' time, euro notes and coins will cement the single-currency area. But, partly thanks to residual protectionism, Europe's banking and insurance industries have yet to exploit borderless finance. Only when that happens will the revolution have truly begun.

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A hypo in New York

Apr 5th 2001 | NEW YORK
From The Economist print edition

AP

Sky high before the fall

ANDREAS Veith walks around HypoVereinsbank's offices in a midtown Manhattan skyscraper, pointing out buildings that the Munich-based institution has recently provided funds for: the Rockefeller Center, the new Trump UN Tower, the Chrysler Building, the IBM Building, the new Bertelsmann Random House Tower near Lincoln Center, and so on, and so on. The full list encompasses a huge swathe of the biggest properties in New York that have changed hands, or been built, over the past decade.

Out of view, but of no less importance, HypoVereinsbank has also become a huge lender in five other big markets: Boston, Washington, Chicago, Los Angeles and San Francisco. Although some of the bank's deals are measured in just a few million dollars, its loans can be as large as $400m. It is even willing to do the hard work necessary for construction finance, which means having architects and engineers on the staff to monitor monthly building updates.

Last year, HypoVereinsbank financed more than $5 billion of transactions. It now has a portfolio in excess of $8 billion, a vast amount in an area that most American banks have assiduously avoided ever since the property bust of the late 1980s. The shift, says Mr Veith, is not a coincidence. "Because they are out, we are in."

How a German bank became one of the largest, if not the largest, force in the market was decided in the darkest days of the 1980s collapse, at what was then known as Hypobank (the merger with Bayerische Vereinsbank occurred in 1997). The bank embarked on an aggressive strategy to expand outside its German heartland—a strategy that met disaster in eastern Germany but produced some great results elsewhere.

During the American property boom in the 1980s, most of the financing was provided by badly managed thrifts (ie, savings banks). They often gave money to developers who themselves had put down as little as 5% on the project and had no tenants lined up to move in. When the market turned down, the thrifts were quick to call in their loans, triggering further distress. "They always get out at the wrong time," says Mr Veith.

HypoVereinsbank's entry in the early 1990s was well timed. Construction had come to a halt, thrifts were being liquidated, and stricter lending standards were being applied. Mr Veith says that the bank has never lost a dollar on American property lending, and consistently earned more than 25% on invested equity.

Now, however, comes the real test. Mr Veith acknowledges that everybody is talking about the slowdown, but he says that the real deterioration has been felt only at the margin. Leases at more than $100 a square foot are no longer being signed, and less than top-notch property that was formerly occupied by technology start-ups is being hit hard. But good space, he says, remains hard to find. HypoVereinsbank's lending was based on rates of $60-65 a square foot, which remains profitable. "Rents are down 5% or 10%; so what?" he asks. Interest rates are down too, making outstanding loans more profitable.

A sceptical New York broker says that there is at least a good chance that, in a severe downturn, HypoVereinsbank will be no different from Citibank a decade ago, which nearly went bust because of its property loans. Ironically, if there is reason to be more optimistic, it is because, this time around, there seem to be no Citibank equivalents providing the unwise competition that makes the boom-and-bust cycles in the property business so severe. Fear may turn out to be Mr Veith's greatest ally.

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Bancassurance

Life branches?

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THE selling of insurance by banks, and vice versa, is a simple enough concept in theory. In practice, though, as Allianz and Dresdner may discover, it is often far from straightforward. In the case of Citibank, for instance, hopes were high following its 1998 merger with Travelers Group that the latter's insurance products would be sold to the bank's customers. In reality, however, there has been only limited integration of the organisation's insurance and banking operations since the merger.

Lots of banks are keen to sell insurance in their branches, mainly because they need to flog as many products as possible to their customers in order to cover the high fixed costs of maintaining their outlets. Insurance companies, on the other hand, usually lack the physical means to reach customers, so they seek access to bank branches as an extra distribution channel.

The natural home of *bancassurance*, the combination of banking and insurance, is in countries such as France and Spain, where people are culturally accustomed to buying insurance from banks. In France, about 60% of life-insurance products are sold through bank branches, according to PricewaterhouseCoopers (PWC), and in Spain 80%. In the Netherlands and Belgium, fund managers and analysts regard companies such as ING and Fortis as evidence that *bancassurance* can work elsewhere too.

So far, though, it has failed to take firm root in any other country. In America, the 1933 Glass-Steagall act long forbade banks and insurers from getting together. That law has now been repealed, but the new Gramm-Leach-Bliley act restricts the sharing of customer information between banks and insurers. Ironically, the act's protection of privacy may make it harder for banks to succeed in insurance, since it makes cross-selling more difficult.

In Britain, the record of selling insurance and banking together has been patchy at best. The banks' share of the life-insurance market is relatively small—about 15%, according to PWC. Other distribution channels (such as independent advisers) continue to dominate the business. One explanation for the difference between Britain and the rest of Europe, says Keith Baird, an analyst with Prudential Bache, is that outside Britain people tend to place far greater trust in their banks. "They have a good reputation; they're not seen as rapacious rip-off artists, as they are in Britain."

Another difficulty is that insurance products are more complex than most banking services and are not easily sold by low-skilled branch staff. In France, banks have solved this by marketing simpler products, making it easier to train staff to give advice about them.

Those who believe in *bancassurance* often disagree about how to put it into practice. From a bank's point of view, does it need to own the company that offers the insurance it sells? And does an insurer need to buy a bank to get its distribution? Bank of Scotland, which has relationships with several insurers, believes that, as consumers become more Internet-savvy and price-conscious, they will want the best insurance products, not a manufactured in-house brand. Some insurance companies say that arm's-length alliances between banks and insurers are better than full-blown mergers. AXA, for instance, a French insurance giant, has distribution agreements with five big banks in France. It says that banking and insurance are far too different to co-exist within the same company. There was a time when Allianz thought the same.

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Currencies

The darling dollar

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From The Economist print edition

INTERNATIONAL investors seem incapable of ending their love affair with the dollar. America's economy has slowed sharply this year, yet its currency has risen to a 15-year high in trade-weighted terms. This week the dollar hit a 30-month high against the yen, almost ¥127. Against the euro it touched $0.88—8% higher than in early January and close to the level at which the European Central Bank and the Federal Reserve jointly intervened to prop up the European currency last September.

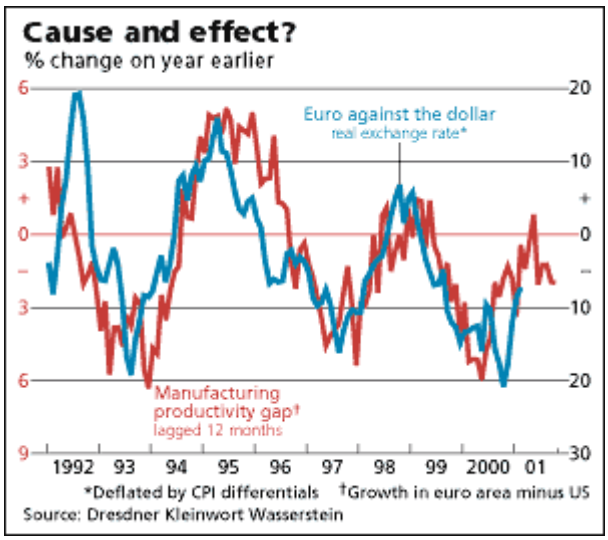
It is easy to understand why the yen is so weak. The Japanese economy remains fragile and the Bank of Japan has eased its monetary policy. The bank's commitment to print more money until consumer prices stop falling will push the yen lower. But the dollar's latest jump against the euro is a puzzle. After hitting a low of $0.82 last October, the euro had gained 16% by January. It has since lost two-thirds of that gain. This week it was trading at 25% below its value at its birth in January 1999.

The old explanation for the euro's weakness—that America is growing faster than the euro area—no longer stands up. Last October, *The Economist*'s poll of forecasters suggested that America's GDP would grow by 3.5% this year, the euro area's by 3%. In our latest poll (see article), the average forecast for America has been slashed to 1.4%, while the euro area is still expected to grow by 2.4%. The premium on American Treasury bonds over German bonds has also fallen sharply. So why is the euro still looking sickly?

There are plenty of theories. One is that the markets do not trust the ECB: the euro-area economies are not immune to America's downturn, yet the central bank still seems more concerned with fighting inflation than with supporting growth. Another intriguing explanation is that criminals in Europe, notably Russian gangsters with suitcases full of D-marks, do not want to have to walk into a bank to exchange them into euros next year, when D-marks and francs cease to be legal tender. So they are shifting into dollars now. Given the vast size of the foreign-exchange market, however, it is unlikely that criminal money, even Russian criminal money, is big enough to move exchange rates.

A more plausible, if more pedestrian, explanation is that, in an uncertain global economic climate, the dollar has resumed its traditional role as a safe-haven currency. Most economists reckon that the euro is undervalued and expect a rebound over the next year. One of the most optimistic is Goldman Sachs, which is predicting a rate of $1.22 in 12 months.

But an analysis by David Owen, an economist at Dresdner Kleinwort Wasserstein, gives pause for thought. He has found that, over the past decade, movements in the real exchange rate of the euro (and before 1999, of its constituent currencies) against the dollar have closely reflected the difference between productivity growth in the euro area and in America (see chart). When productivity growth in America has been faster than in Europe—as it was in most of the late 1990s—the euro falls, and vice versa.



This is exactly what economic theory would predict: countries with faster productivity growth in the traded-goods sector should see rising real exchange rates. Mr Owen uses monthly data for productivity growth in manufacturing, a good proxy for the traded-goods sector. Using annual productivity data for the whole economy (which are available over a longer period), the broad relationship between the exchange rate and relative productivity growth in America and Europe seems to have persisted for most of the past 30 years.

Mr Owen reckons that, in the short term, America's downturn will reduce the productivity gap between America and the euro area—and so boost the euro. But in the long term, he expects productivity growth to remain faster in America—in which case, a sustained rise in the euro is unlikely over the next few years. Only if the downturn completely kills the belief in America's new paradigm, and its productivity growth plummets, will the euro be able to rebound more permanently.

The strength of the dollar this year does indeed seem to hinge on a belief among investors that America's slowdown will be brief, and that in the longer run America remains the best place in which to invest. But they may be underestimating the potential for productivity gains in Europe, as the single currency boosts competition and encourages firms to exploit economies of scale through mergers and acquisitions. The adoption of more flexible working practices in many countries should also help to improve productivity.

Studies in America suggest that the bulk of its productivity gains from information technology come from the use of IT rather than from its production. So the euro area, too, should start to enjoy productivity gains over the next decade, as it makes fuller use of IT. If you believe that Europe really is starting to change, buy euros. If not, stick with the darling dollar.

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The Marjorie Deane internship

Apr 5th 2001
From The Economist print edition

Applications are invited for the 2001 Marjorie Deane internship. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a would-be or junior journalist under 28, who will spend three months of the summer at *The Economist*, writing about finance. Applicants should send a letter introducing themselves, with an original article of about 1,000 words intended for the Finance and Economics section. Applications must reach us by April 17th, and should be posted to: The business affairs editor (Deane internship), The Economist, 25 St James's Street, London SW1A 1HG

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Pharmaceutical shares

Pills popping up

Apr 5th 2001 | NEW YORK
From The Economist print edition

THE very biggest companies in America have always reflected the nature of the American economy itself. At the beginning of the 20th century, it was railroad firms that had the largest stockmarket value. Then it was steel; then cars; and then energy. By the end of the 20th century, technology had become the undisputed king, accounting last March for a staggering one-third of the S&P 500 index. Now, however, there is a whiff of change in the air. Technology companies continue to dominate the index, but their share has fallen to 21%. Meanwhile, the share of health-care stocks has increased from 9% to 13%, and could still have some way to go.

It is not inconceivable that a pharmaceuticals company will soon become the most highly valued company in the world. Pfizer, which first shot up in value when it launched the anti-impotence drug Viagra in 1998, became the world's largest pharmaceuticals firm after its merger last year with Warner-Lambert. It has now jumped past Cisco Systems, IBM, Lucent and Intel to become the fourth most highly valued company, with a market capitalisation of $245 billion. The three companies above it are not unassailable. Exxon Mobil, valued at $275 billion, has far less control over the pricing of its products than Pfizer, whereas Microsoft, valued at $297 billion, has less reliable demand for its products.

General Electric—currently the most highly valued company (at $415 billion)—would seem to be in a class of its own. But consider if GE were to lose the special premium awarded because of its soon-to-retire celebrity chief executive (Jack Welch). It might then be treated more like a normal conglomerate, and that could halve its valuation overnight. Impossible? Well, that is precisely what happened to Coca-Cola and several other companies after the departure of a high-profile leader.

A high market value for an industry reflects a confidence in the ability of companies in that industry to earn consistently large profits—ie, it reflects confidence in enduring demand for what those companies have to offer. Samuel Isaly, manager of the Eaton Vance Worldwide Health Sciences Fund, says that earnings of the biggest 50 pharmaceutical companies will probably continue to grow at about 12% annually (with returns on equity approaching 20%). Large pharmaceutical companies are far less cyclical than most other sectors of the economy. They depend on people getting sick, which (plagues aside) occurs with a consistency that is reassuring for investors, if disturbing for everybody else.

New products continue to flow from the industry. In the mid-1980s, some 20 new drugs a year survived the Food & Drug Administration's regulatory review process. That number has since more than doubled, and Mr Isaly believes that 40-50 new approvals per year are sustainable. Just as important, the time required for approval has dropped from almost three years to one.

New lucrative categories continue to emerge. Lipitor, an anti-cholesterol drug sold by Pfizer that has been on the market since January 1997, already has annual sales approaching $6 billion, making it about the same size as the largest anti-ulcer medications, traditionally the biggest sellers. The most profitable drug in the world, Mr Isaly believes, will be one that treats Alzheimer's; and its launch may not be many years away.

Having a bunch of drug behemoths on top of the market may not be good news for Wall Street's investment bankers. The leading companies in the steel, energy and (to a large extent) technology sectors were invariably short of capital. The enthusiasm with which their shares were touted helped to feed past market booms and busts. The big drug companies, on the other hand, are largely self-financing and in a position to pay out 40% of their profits in dividends. If their ascendancy holds, they could act as a powerful sedative on the markets.

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The World Bank

Reform school

Apr 5th 2001
From The Economist print edition

THE World Bank thinks it has discovered a great truth: if you give money to a recalcitrant junkie, he will waste it. To prove this astounding thesis, it has studied the effects of aid in ten African countries. It recently published the results in a 360-page document. The findings reveal that, when the government of a country is committed to economic reforms, development assistance produces economic growth. But when the government is not so committed, aid has little or no positive influence. “Aid cannot buy reform,” concludes Shanta Devarajan, a co-author of the report.

In the 1980s and 1990s, World Bank and International Monetary Fund officials wrote economic policy for African governments and bribed them with aid into signing up to it. Billions of dollars were wasted. These days, conditionality is out as a tool to force governments to reform. In its place comes ownership. Governments have to write their own “Poverty Reduction Strategies”, as economic reform policy is called these days.

Not surprisingly, the two countries that come out top in terms of economic performance, Ghana and Uganda, are those whose leaders became most committed to reform. The losers, Nigeria and Congo, were those whose leaders measured economic success almost solely in terms of their own bank accounts. The research fits nicely with the World Bank’s new philosophy that countries—not just governments, but their people too—have to “own” the reforms.

So far, so good. But has it really changed the African countries that have followed the new philosophy? Ghana and Uganda had no choice. Their leaders took power by force in the early 1980s, when their countries had reached a nadir. Neither leader believed in the free market when they came to power, but there was no alternative and there was only one way to go—up. These days, the governments may have to write their own policies, but they now know exactly what they have to put in them if they want to get aid.

A quick check through their policy documents reveals that they adopt the same approaches, address the same problems, and use the same language. They know now, just as they did in the old conditionality days, that if they want aid and debt relief, they have to sign up to reducing inflation, cutting state spending and privatising, among a raft of other policies. Whether they believe in these pledges is a different matter.

Kenya will be a test case. For decades, its rulers have been model pupils, copying every World Bank whim into their policy papers. They did just enough to get the aid money, then, as soon as the donors turned away, they started behaving like the leaders of Nigeria and Congo. Even now, they are pretending to play the World Bank game and, incredibly, the bank seems to be taking them seriously.

There is a strong suspicion in Africa that the decision to lend or not to lend depends more on the ambition of World Bank officials than on the commitment or otherwise of the government to which they are lending. Pushing money out of the door, as the phrase at the bank’s headquarters has it, is vital if you want to get on. So perhaps the bank should look at the relationship between the money pushed out of its door and the career paths of its country directors. That could show some heavy dependence.

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Tongue-tied

Apr 5th 2001
From The Economist print edition

THESE are halcyon days for translators and interpreters. International meetings abound: the European summit in Stockholm last month, the Summit of the Americas in Quebec in two weeks' time, International Monetary Fund and World Bank meetings the week after, and an OECD ministerial meeting in May—to name but a few. As global government grows, so do the costs of translation.

The issue is most pressing at the World Trade Organisation (WTO). It spent some SFr28m ($16m) on language services in 2000. At 22% of its budget, that put the WTO at the top of all international groups. A full quarter of its employees are devoted to translation, interpreting and foreign-language typing.

Although the WTO's language-related costs have jumped by 120% since its founding in 1995, its budget for translation and interpreting has risen by only 20%. The resulting bureaucratic logjams slow the release of official documents and transcripts, which reduces the WTO's transparency. The situation is an immense source of frustration to Mike Moore, the WTO's director-general.

Despite claiming 140 members (who encircle the globe), the WTO works only in English, French and Spanish. Services in other languages are paid for independently by outside foundations or member governments—which is just as well, since adding new languages for new members would be a sticky business. If China were to insist that Mandarin be added to the WTO's official languages when it joins the group, the cost to the organisation would be about $5m a year. But China's membership dues, to be based on its share in world trade, will amount to only $2.5m.

Part of the WTO's language problem is its centralised architecture. The World Bank uses six languages for most of its communications: English, French, Mandarin, Portuguese, Russian and Spanish. However, through its multilingual employees at field offices around the world, the organisation services 56 different tongues—at a cost of only $6.6m. In the European Union, political pressures are such that, at most big meetings and in the parliament, 11 languages from the 15 member states must be used. That number will rise dramatically when East Europe's transitional economies join.

Dropping languages can be more controversial than adding them. Last year's Finnish EU presidency provoked boycotts when it tried to downgrade German. And Raimondo Harari of the International Labour Organisation, which uses seven "working languages", recalls that "quite a havoc" arose when a former head of the ILO suggested saving money by ceasing to offer Arabic, Chinese, German and Russian interpretation at some meetings. When it comes to such a politically sensitive issue, Mr Harari says, "cost-benefit analysis doesn't make any sense".

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Economics focus

Of prophets and profits

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Beware attempts to forecast company profits

IN A witty new advertisement for Charles Schwab, a stockbroking firm, no less a market guru than Sarah Ferguson, the Duchess of York, warns a young princess of the need to understand the "difference between a p/e ratio and a dividend yield". Not long ago, the phrase "price/earnings ratio" and its abbreviation were part of the secret language of professional investors. Now, thanks to the transformation of share trading into America's national pastime, the p/e—the ratio of a company's share price to its profits (ie, earnings) per share—has become part of the vernacular.

But even if the duchess, along with countless millions of other individual investors, can calculate a p/e ratio, will the knowledge do her any good? A p/e ratio provides a crude yardstick of investor optimism. The higher the p/e, the more investors are betting that the firm's future profits will grow. Whether any given level of optimism is a proper reflection of a firm's prospects will always be open to fierce debate.

Economists have become increasingly active in this debate in recent years, as the long bull market in shares propelled p/e ratios to levels that in most cases remain well above historic norms, even after the stockmarket tumbles of the past year. At the end of March, the average "forward-looking" p/e of American firms (as tracked by IBES, a research firm) was 21, based on forecast profits for the coming year. (A "trailing" p/e uses the past year's profits.) This is well down from a year ago: when share prices were at their peak, the IBES average p/e was 26. But it is, even now, hardly low. Since 1980, the ratio has averaged a mere 15.

Some economists think that such high p/e ratios are symptomatic of a stockmarket bubble. Others focus on the relationship between share prices and the returns available on alternative assets, such as bond yields. At a time when bond yields are relatively low, the earnings stream available from shares may be worth paying more for. The flaw here is that, although nominal yields have fallen sharply, so too has inflation. Real bond yields are not especially low by historic standards.

Perhaps there has been a sharp fall in the "equity risk premium"—the extra returns that investors require, on average, as a reward for bearing the extra risk involved in buying shares rather than, say, Treasury bonds. A lower risk premium means that investors will pay more for any given expected stream of future profits—ie, that the p/e will be higher.

Certainly, there are reasons why the premium might have fallen—ranging from an increase in the number of investors with experience of shares to easier access to credit with which to buy shares. On the other hand, current p/e ratios are so high that they seem to imply (implausibly) that investors now think shares are safer than bonds—ie, the equity premium is negative. Unless, that is, profits are about to grow at a rate never seen before.

Which is precisely what many Wall Street analysts have predicted in recent years, pointing in justification to such blessings as freer markets and the technological transformation of the "new economy". Indeed, despite the deluge of disappointing profits news pouring out of companies so far this year, analysts continue to forecast spectacular long-term profits growth. At the end of March, the average forecast for firms tracked by IBES was of annual profits growth of 19.8% over the coming 3-5 years, barely down from the peak forecast last year of 20.2%. One erstwhile stockmarket darling, Cisco Systems, is still forecast to average 30% annual profits growth during this period.

How plausible are such forecasts? Not very, at least if the past is any guide, concludes a new study by

Louis Chan, Jason Karceski and Josef Lakonishok*. They analysed the performance of all active American public companies in 1951-97, and found that the growth now forecast by analysts is way above historic norms. At only one firm in ten did profits grow by 18% or more per year over any ten-year period.

Maybe fundamental economic changes will allow faster growth in future. But, strikingly, the study found no evidence that median long-term profits growth rates have increased in recent years—when those changes presumably started to take effect. Nor is there evidence that analysts are any good at forecasting profits growth. Data on their forecasts for firms in the IBES sample have been available only since 1982. In 1982-98, the median forecast annual growth rate for any 3-5 year period was 14.5%. The median growth rate actually delivered was only 9%. Analysts seem to have been consistently over-optimistic; perhaps because it is in their psyche, or perhaps because they are paid to be that way.

Picking losers

Analysts were no better at predicting the performance of individual companies. Just as investors are willing to accept higher p/e ratios for firms that have enjoyed above-average profits growth in recent years, so too analysts typically forecast that recent outperformers will continue to beat the average.

In general, the rates of increase of profits have tended to converge. Firms do not remain indefinitely on a high or low growth path, a fact that accords with simple economic intuition. Above-average growth in profits should stimulate competition, which should slow the successful firm's growth. On the other hand, the exit of under-performers from unprofitable lines of business should increase their future growth rate.

The study concludes that, whatever happens to the future growth rates of profits (and it would be a brave man who would bet on them bucking the historic trend), it should be no surprise if the firms enjoying the fastest growth are not those that have grown fastest in the past. Nor will they be those that analysts are tipping for greatness. Nor, the Duchess of York should note, will they be those that have the highest p/e ratios.

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*"The Level and Persistence of Growth Rates". University of Illinois working paper, March 2001.

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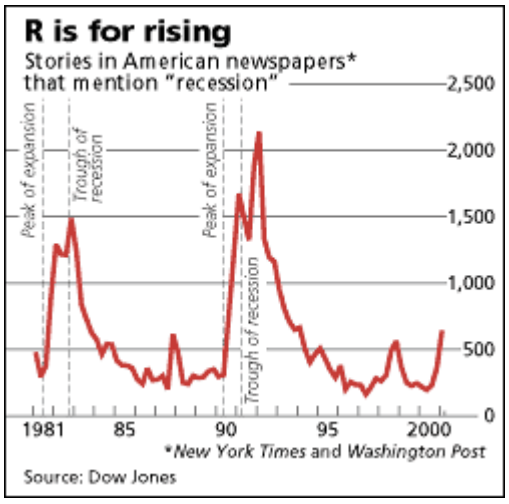
The R-word

Apr 5th 2001
From The Economist print edition

THE R-word index, which we began tracking for the American economy early this year, has started flashing red. Using a computer database, we count for each quarter how many stories that appear in the *New York Times* and the *Washington Post* include the word "recession". This "R-count" increased sharply in the first quarter of this year, to around 650 articles, three times its level in the middle of last year.

Over the past two decades, the R-word index has been pretty good at spotting economic turning-points. It accurately pinpointed the start of recession in both 1981 and 1990, and although the R-count today remains well below its peak during those two recessions, over the past 20 years an increase on that scale has always signalled the start of recession. In the third quarter of 1990, the R-count more than doubled to 750 (see chart). Initial GDP figures for that quarter showed that the American economy was still expanding, but they were later revised to show there had been a small contraction.

If the R-word were a lagging indicator, simply occurring more often when bad economic statistics are reported, it would be of little value. But it seems to be a coincident indicator, turning at roughly the same time as output. Its big advantage is that it is instantly available, unlike official statistics, which are always out of date. The latest GDP figures for America, for example, refer only to the fourth quarter of 2000. The numbers for the first quarter of this year will not be published until the end of April.



Some critics accuse the press of talking the economy into recession. More stories about recession, they claim, make businessmen and consumers feel gloomy, and so they stop spending. That is a bit unfair: the R-word index is merely a coincident, not a leading indicator of recession. Writing about recession does not by itself cause a downturn—but it may help to exacerbate it. So reading this article may be bad for your wealth.

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Martian invasion? Not yet

Apr 5th 2001
From The Economist print edition

Get article background

WHEN he was president, George Bush senior said he wanted America to put people on Mars by 2019, the 50th anniversary of the first moonwalk. His son, too, has great plans for the planet. Although other areas of physical science are threatened with budget cuts, space-exploration seems still to be a favoured child. There are, nevertheless, many questions to address before NASA, America's space agency, launches a manned mission to the planet.

After *Apollo*, and in the age of the shuttle, putting somebody into space might seem mundane. But as Jim Garvin, the chief scientist of NASA's Mars programme, points out, it has been 28 years since anybody went as far into space as the moon—and that journey is a five-hundredth of the distance it would take to travel to Mars.

Deep space is a hostile environment, filled with radiation both from the sun and, in the form of cosmic rays, from the rest of the galaxy. An astronaut travelling to Mars would be exposed to this radiation for the six months it would take to reach the planet, and the six months of the return journey. Effective shielding would be difficult to incorporate in a spacecraft. Every extra kilogram that the craft weighs piles on the dollars in the form of launch costs.

Nor would an astronaut necessarily be safe on the Martian surface. Scientific knowledge of the Martian environment is still in its infancy. Researchers have no idea how toxic the planet's rocks and (more pertinently) its dust are, and they will not know until they can bring back and analyse samples. Nor do they know the level of ultraviolet light at the Martian surface, although it is likely to be similar to that found above the ozone layer on earth—ie, too high for comfort.

Another obstacle is technological. A spacecraft capable of carrying a crew to Mars and back (a journey of about 320m kilometres) would be fiendishly difficult to build. NASA's success rate with robot craft is only 60%, and those do not need life-support systems—nor do they have to make the return journey. On top of this, if the astronauts were to fall ill, existing "telemedicine" is not yet dependable enough to allow them to diagnose and treat themselves unaided.

Perhaps the biggest problem, though, would be psychological. Shutting a small group of people up in a tin can for months on end could lead—quite literally—to murder. Even Antarctic explorers had the option of leaving the tent for a while, when they could no longer stand their fellow travellers. In space you cannot say, as Captain Oates did to his colleagues on Scott's doomed expedition to the South Pole, "I am just going outside, and may be some time..."

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Martian chronicles

Apr 5th 2001
From The Economist print edition

The more scientists know about the place, the less they understand it. Will this weekend's launch of a new mission to Mars help?

Get article background

Reuters

ON APRIL 7th, if all goes well, America's space agency NASA will renew its assault on Mars. The craft it is launching—dubbed the *2001 Mars Odyssey*—should go into orbit around the planet in October. It will then spend one Martian year (ie, about two terrestrial ones) examining the surface, using three instruments. One is a thermal-emission imaging system, designed to study minerals by examining the infra-red light that they emit. The second is a gamma-ray spectrometer, which will probe the soil in a search for, among other things, hydrogen (and, by association, water). The third is a radiation experiment designed to work out how dangerous the Martian environment might be for human exploration.

Despite several recent setbacks (two unmanned craft lost in the past two years) and disappointments (evidence of bacteria in a meteorite made of Mars rock is fiercely disputed), Mars continues to hold human imagination in its grip. If manned spaceflight continues at all, a trip there seems almost inevitable. And if the astronauts who go do not find evidence of Martians, even lowly bacterial ones, one of the great icons of modern times will have vanished.

Schiaperelli's hare

Fascination with Mars started many centuries ago. Its fiery colour and erratic movement across the night sky terrified the ancient Greeks and Romans, causing them to name the planet after their gods of war. Giovanni Schiaperelli, an Italian astronomer, created a detailed gazetteer of the planet in the 19th century, using such beguiling names as Olympus and Elysium for the features he saw through his telescope. In 1877, Schiaperelli thought he saw streaks on the Martian surface, and referred to them in his publications as *canali*, the Italian word for channels. That word was, however, mistranslated into English as "canals", and theories of an inhabited Mars irrigated by melt-waters from the polar ice caps began to flourish. Soon, a mere mention of the planet inspired visions of foreign worlds and fears of alien invasion, and it has since been the subject of countless science-fiction tales.

So it was to everybody's disappointment that *Mariner 4*, the first space probe to fly past Mars (in 1965), revealed a place with a surface that appeared to have been static for billions of years. The atmosphere was thin, dry and made mostly of carbon dioxide. There were no canals, no little green men, no signs of life whatsoever. But a later mission, *Mariner 9*, showed in 1971 that the surface had extensive sand dunes, massive craters and huge lava flows. It was also prone to dust storms. Best of all, the probe found that, although Schiaperelli's original *canali* were indeed an artefact of his telescope, the planet did have canyons and what appeared to be networks of valleys that seemed to have been carved by water flows aeons ago.

That evidence of water was exciting, for with it came the possibility of life. But it was also puzzling. The Martian atmosphere is so thin, and the planet's temperature so low (averaging -60°C), that liquid water could not exist there. If it ever did in the past, conditions must have been very different. If that was the case, what became of the water when those conditions changed? It is clearly not in the atmosphere. Nor is it frozen at the poles (these are made largely of solid carbon dioxide; the amount of water-ice they contain could not possibly have carved the valleys that are visible). It could be underground, in a so-called "cryosphere", but checking that idea would require extensive exploration below the surface.

In any case, if there was water on Mars, it was a long time in the past; perhaps as much as 4 billion years ago. The picture *Mariner 9* painted of modern Mars was of a static desert, with none of the jostling of tectonic plates that makes life interesting for geologists by throwing up island chains and mountain ranges, and opening deep basins for oceans to form in. Yet many areologists, as students of Mars are sometimes known, could not let go of the idea that the object of their affections was once an active world like the earth. Nor could they quite convince themselves that life—even if it was only bacterial life—had never dwelt there.

With the *Viking* missions in the 1970s—which included two orbiting probes and two landing craft—areologists got more details of Martian topography. But they also got a disappointment. One of the landers contained a small reactor designed to encourage the growth of micro-organisms. A sample of Martian soil was put into it, but nothing interesting happened.

The *Viking* missions were followed by a 20-year drought. Three spacecraft (two Russian and one American) were sent in the planet's direction, but all fell victim to the Great Galactic Ghoul that some researchers jokingly suggest protects Mars from human prying. In 1996, however, a craft got past the ghoul. *Mars Pathfinder* landed in a region dubbed Ares Vallis, amid all the hoopla that NASA excels in. Shortly afterwards, *Mars Global Surveyor* arrived, and the modern era of Martian exploration began. *Global Surveyor*, which has mapped the whole Martian surface, some of it down to a resolution of 1.5 metres, has shown that those areologists who kept the faith were right. Mars is not a static world after all. It is a dynamic planet whose surface is in constant flux.

Global Surveyor, which is still contentedly zipping around the place, is equipped with four instruments. A high-resolution camera provides the pictures. A laser altimeter (the Mars Orbiter Laser Altimeter, or MOLA) measures the height of landscape features. A thermal-emission spectrometer (TES) similar to the one on *Odyssey* looks at the minerals. And a magnetometer measures the planet's magnetic field.

All four instruments have sent back data that have turned the science of Mars on its head. The camera has produced images of recently formed water-carved structures, and MOLA, which works by bouncing beams of light off the planet's surface, has found mountains twice as high as Everest, a crater ten kilometres deep, and huge valleys carved by more water than scientists believed had ever existed on Mars. Yet TES has detected minerals which seem to indicate that water could not possibly have created those valleys. And the magnetometer has found a distinctive magnetic signature which, some claim, suggests that Mars, too, may once have had tectonic plates.

The surprises seem endless. Last June, the scientific community was stunned by the announcement that there were signs of liquid water on modern Mars after all. Mike Malin and Ken Edgett work for Malin Space Science Systems, a company contracted by NASA to build the camera on board *Global Surveyor* and to analyse some of the photographs. They found gullies that, had they been seen in aerial photographs of the earth, would unhesitatingly have been identified as water-carved. By Martian standards, these gullies appear to be young, since some of them have eroded features such as meteoritic craters that are known to have formed relatively recently. Dr Malin and Dr Edgett suggest that the gullies are being created by water that is either seeping slowly to the surface or building up behind barriers of ice and occasionally bursting through.

Unfortunately, the data from TES show no evidence of the sorts of minerals, such as clays and carbonates, that tend to form (at least on earth) in the presence of water. Even more disconcerting was the discovery of a substantial quantity (about 2 1/2m square kilometres) of rock made of a mineral called olivine. This substance (an iron-magnesium silicate whose greenish colour is reminiscent of olives) weathers rapidly in the presence of water. Its abundance on Mars suggests that the planet has been cold and dry throughout most of its history.

Any water rushing through the Martian valleys would therefore have to have vanished before the olivine was deposited. According to Michael Carr, a geologist who works for the US Geological Survey, the data are very puzzling. All the chemical and mineralogical evidence suggests that there have been no warm and wet periods in Martian history. The topographical evidence, on the other hand, shows that there has been water all over the place.

Or, at least, it shows there has been liquid. One way out of the dilemma was suggested last August by Nick Hoffman, a geologist at La Trobe University in Melbourne. Dr Hoffman's theory, which has become known as "white Mars", is that the canyons on the planet are, indeed, the result of floods. Those floods, though, were not of liquid water but of liquid carbon dioxide.

That hypothesis opens up another explanation for the gullies. A paper in this week's *Geophysical Research Letters*, written by Donald Musselwhite and his colleagues at the University of Arizona, suggests that those features could have been caused by the rapid vaporisation of liquid carbon dioxide. This would create a fluid that, although a gas, would have a similar density and cutting power to that of water.

Oceans of data

The oddities do not stop there. Soon after information from MOLA began to arrive, some areologists thought they detected signs of an ancient shoreline, indicating what could have been the edges of a lost ocean. The idea of oceans on Mars is not new: Tim Parker, a NASA scientist, first proposed it in 1989. He thought he saw what looked like shorelines in pictures taken by *Viking*. His theory made a lot of sense, for the floodwaters that caused the channels on the planet must have gone somewhere. Dr Parker suggested that they collected in the lowlands of Mars's northern hemisphere, resulting in an ocean.

Since then, the ocean has been proved (according to some) and disproved (according to others). If the ocean once existed, the alleged shoreline should have an elevation that stays relatively constant. Also, the plains below should be smooth, thanks to a build-up of sediment over time, as happens at the bottom of terrestrial oceans.

This was exactly what James Head, of Brown University, and his colleagues reported finding in 1999. As a bonus, the oceanic basin they thought they had identified would have held roughly the same amount of water (between 60m and 200m cubic kilometres) as would have been required to carve the valleys on the planet's surface. Around the same time, however, Dr Edgett and Dr Malin were failing to find any photographic evidence from *Global Surveyor*, such as coastal cliffs, that would have pointed to an oceanic past.

Mars's climate is another hotly debated phenomenon. In order for liquid water to have existed on the planet, the temperature would (obviously) have had to have been above freezing point. Water vapour, however, is a powerful greenhouse gas, so any evaporation (or, strictly, sublimation) from ice on the surface would heat the planet. That could create positive feedback, as the extra warmth increased the amount of sublimation. Some researchers think that this process could have heated Mars enough for liquid water to have formed on the surface. But that would have to have happened early in Martian history, so as to give time for the olivine to be laid down afterwards.

On the other hand, carbon dioxide is also a greenhouse gas. Enough of that might have heated Mars to the point where ice melts. In a recent issue of *Science*, Roger Phillips, of Washington University in St Louis, and his colleagues published a model based on MOLA data. This suggested that Tharsis, a feature named by Schiaperelli that has turned out to contain several huge volcanoes, could have produced enough lava, and released enough carbon dioxide, to warm the atmosphere sufficiently for enough ice to melt to create the flood channels seen today.

Mars attacks

To astrobiologists (who study, or, rather, would like to study, non-terrestrial life), theories such as Dr Phillips's are attractive because they do not rule out the possibility of life in the way that Dr Hoffman's "white Mars" would. And not much has changed since the early days of Mars's exploration: the search for life is still what it is all about.

It will be a long time before a manned mission to Mars is possible (see article), but in the meantime NASA has plans to continue its search for Martian life. The agency intends to launch a probe every two years for the next decade. By 2011, it hopes to have finished with this "reconnaissance" phase, and to be ready to launch a craft that will bring samples back from Mars.

Odyssey is the first mission of this revamped plan, and NASA has spent an additional $12m to ensure that this craft will not fall victim to the same ghoulish fate as its two immediate predecessors. In 2003, the landers will come: twin rovers that will look for water on the planet and attempt to determine its climatic history.

NASA is not the only agency pointing its spaceships' noses towards Mars in 2003, however. As Scott Hubbard, the new director of NASA's Mars programme, points out, the planet is due for a bit of a traffic

jam that year. As well as NASA's rovers, an international mission called *Mars Express*, backed by the European Space Agency, will orbit the planet and send down a British lander. And a Japanese mission, launched in 1998 on a rather longer trajectory than that employed by NASA, should arrive there at about the same time.

Fascination with Mars will not, it seems, go away. From gods to space-aliens to bacteria, each new generation remakes the myths in its own image. One day, though, the truth will out. Whether the myths will survive the dose of reality that all these spacecraft bring remains to be seen.

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Hope in a hate-infected city

Apr 5th 2001
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Jerusalem looks as divided and explosive as ever. But is the future of the city really so bleak?

THE jaded or lazy observer of Jerusalem may imagine that nothing is new under the sun. The holy city has been fought over for centuries and is being fought over still. Even the patterns of conflict look wearily familiar. Last September it was Ariel Sharon's venture into the Haram al-Sharif, which Jews know as Temple Mount, that appeared to set off the latest Palestinian *intifada* against Israeli rule, in which hundreds of people, mostly Arabs, have since been killed. More than 70 years ago, in 1929, a quarrel about control of the Western Wall sparked riots throughout Jerusalem, and then throughout Palestine, in which 133 Jews and 116 Arabs were killed. And so it goes on.

For all that, as three new books about the city attest, nothing really stands still in Jerusalem. Nor is the present conflict for control of it necessarily insoluble. Each of these books concedes that the conflict has become unusually complex. It takes the double form of a conflict between religions and a conflict between nationalisms. The fire of one conflict feeds the fire of the other. But the saving grace of Jerusalem is that it is also a city. Whether they like it or not, its inhabitants are in close daily contact. Arabs and Jews cannot simply wish one another away. Menachem Klein, an Israeli political scientist, argues that the Israelis and Palestinians in Jerusalem have despite everything moved closer to each other. One reason why is that Israel's post-1967 dream of making Jerusalem into a predominantly Jewish capital has comprehensively failed. Not even the United States, its closest ally, has accepted Israeli sovereignty over the conquered eastern half of the city. But as Bernard Wasserstein's history of the controversy makes plain, diplomacy has had little impact on Jerusalem since Israel and Jordan divided it in their war of 1948. The more significant Israeli failures have been in local politics, and in demography.

Jews have formed a majority in Jerusalem since the late 19th century. But their majority has never grown big enough to cancel out either Arab claims to the city or the proposals of outsiders, from the United Nations to the Vatican, to give it an international status. After 1967, in an effort to create irreversible facts on the ground, Israel encircled the city with Jewish suburbs and did its utmost to obstruct Arab construction. Nonetheless, it has been losing demographically. In 1967 Jews made up 74% of the city's population. By December 1999 Jerusalem had a population of 646,000, of whom 68% were Jews.

This demographic retreat has gone along with a political one. From 1967 to 1993, Teddy Kollek, a charismatic mayor, tried to fasten the city to Israel by what Mr Wasserstein calls, perhaps a little generously, "the determined application of goodwill rather than force". This, too, was a failure. Almost all of the city's Arabs refused Israeli citizenship. More recently, the Oslo peace process gave the embryonic political institutions of the embryonic Palestine a powerful foothold in the city, symbolised by the

JERUSALEM: THE CONTESTED CITY
By Menachem Klein

New York University; 363 pages; $36.
Hurst; £45 (Ã‚Â£17.50 paperback).

Buy it at
Amazon.com
Amazon.co.uk

Divided Jerusalem: The Struggle for the Holy City
By Bernard Wasserstein

Yale University Press; 432 pages; $29.95
Profile Books; 432 pages; £20

Buy it at
Amazon.com
Amazon.co.uk

THE END OF DAYS: FUNDAMENTALISM AND THE STRUGGLE FOR THE TEMPLE MOUNT
By Gershom Gorenberg

Free Press; 288 pages; $25 and £17.99

Buy it at
Amazon.com
Amazon.co.uk

transformation of Orient House, a former hotel, into a cross between a town hall and an embassy. By the second half of the 1990s, the Palestinian Authority had gained day-to-day control over large areas of daily life in the Arab-inhabited areas of Jerusalem.

To men of Mr Klein's practical disposition, the scope of Israel's failure to colonise the city inspires hope. The resilience of the two main communities obliges each to recognise the impracticality of its maximal demands. Most Palestinians seem to accept that there can be no return to pre-1967 partition: if nothing else, the changes Israel has made in the face of the city rule that out. And recognition is dawning among Israelis that the fiction of a united capital cannot be sustained in a city divided by hatred. Not long ago, when Israel still officially insisted on eternal rule, Israelis and Palestinians began to sketch the outlines of the compromise—twin municipalities, the fudging of sovereignty over the holy places—that Ehud Barak put to Yasser Arafat last year at Camp David.

It is, of course, true that Camp David failed, and so put an end both to the Oslo process and to the Barak premiership. And it is true, as Gershom Gorenberg argues in his racy discussion of the various weird cults with designs on Temple Mount, that Jerusalem does not want for religious crackpots of every persuasion who would resort to violence in pursuit of some millenarian dream. But the part of religion—and of Jerusalem—in the Palestine conflict can also be exaggerated. As Mr Wasserstein points out, the significance of Jerusalem waxes and wanes. In the late 1940s, when Zionism was a mainly secular movement, David Ben Gurion was willing to accept an international status for the city as part of the price the Jews might have to pay for statehood.

These books were published too late for their authors to weigh the consequences of the new *intifada*. Over the past six months, the religious part of the conflict seems to have waxed, not waned: Palestinians have called their latest uprising the al-Aqsa *intifada*, after the mosque on Temple Mount. However, the past half-century has also witnessed the gradual realisation by growing numbers of Arabs and Jews in Palestine that, even if a final peace has so far eluded them, neither side can extinguish the national aspirations of the other. There, at least, is some ground for hope.

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Jerusalem, thou that killeth

Apr 5th 2001
From The Economist print edition

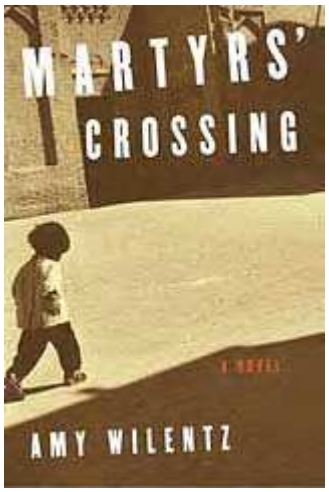
INVISIBLE lines scar the pavements of Jerusalem, locking the inhabitants into their own districts as firmly as prison bars. Arabs are confined to their sadly diminished areas, orthodox Jews rarely stray from their crowded districts and secular Israelis instinctively know where the inner borders of their capital lie.

MARTYRS' CROSSING
By Amy Wilentz

Simon & Schuster; 320 pages; $24

Buy it at
Amazon.com
Amazon.co.uk

One of the advantages of being a foreigner is that you can criss-cross these divides. Amy Wilentz, a journalist who wrote for the *New Yorker* from Jerusalem, has used this privilege well. Her first novel, "Martyrs' Crossing" begins with a fictional but entirely plausible incident at a checkpoint outside the Palestinian town of Ramallah, on the road to Jerusalem.



A young woman has a dangerously ill child. The local clinics are pitiful and her son's best chance of survival is at an Israeli hospital. However, in retaliation for a terrorist incident, Israeli troops have closed Ramallah and a riot is developing just beyond the military checkpoint that controls the road to Jerusalem. Rushing her suffocating baby through the tear gas, Marina proudly puts herself at the mercy of a young Israeli lieutenant, Ari Doron. As he struggles to allow natural empathy to overrule military discipline, the child dies. Once it becomes clear that American-born Marina is the daughter of a prominent Palestinian intellectual and the wife of a jailed Hamas activist, and that Doron's orders to deny Marina access came from the highest echelon of the Israeli security system, the stage is set for a battle for the moral high-ground which leaves both sides tarnished.

Ms Wilentz's skill in this story, which has echoes of "Romeo and Juliet", is to enter the grey zone on both sides. Her deep and unbiased knowledge of the history of the struggle between the Israeli and the Palestinian people drives her not to apportion blame, but to examine the personal consequences of political struggle. The result is a finely nuanced novel which effectively conveys the interconnected guilt, humiliation and degradation of both sides.

Many of the characters in her novel bear strong resemblance to the real politicians who lead—or mislead—their respective peoples. Yasser Arafat and Yitzhak Rabin are both present in unnamed cameo roles. But it is the Edward Said-like character of George Raad, Marina's father, who comes most effectively to life in this novel. Still bearing the key to his Jerusalem childhood home which he was forced to flee in 1947, Raad returns to Palestine an old and broken man. He has made a life for himself as a doctor in America, but his hopes and dreams of a free Palestine infected his daughter and have led directly, as he comes to see it, to the death of his grandson. And as the Palestinian authority, led by a childhood friend whom he has come to hate, tries to make political capital from this death, Raad is forced to re-evaluate the political underpinning of his entire life.

Ms Wilentz's accurate topography and her deep engagement with contemporary politics push her novel to the very borders of non-fiction. But in rare moments of lyricism she makes readers long for the momentary bloom of grass on the desert hills in spring and the pervasive smell of paraffin heaters in winter as they struggle in vain against the dense cold of Jerusalem stone.

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20th-century America

Not proven

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THE 1970s strike many Americans, in Bruce Schulman's words, as an "eminently forgettable decade—an era of bad clothes, bad hair, and bad music impossible to take seriously." The perfect symbol of the 1970s, another American has joked, was the novelty pet rock, "which just sat there doing nothing".

THE SEVENTIES: THE GREAT SHIFT IN AMERICAN CULTURE, SOCIETY AND POLITICS
By Bruce J. Schulman

Free Press; 352 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

Mr Schulman, a professor of history and director of American Studies at Boston University, tells us that his students share this dismissive view of the 1970s. For the past ten years he has asked his classes to identify one person who embodies for them the 1960s, the 1970s, and the 1980s. His students name John Kennedy, Martin Luther King or Bob Dylan for the 1960s; and Ronald Reagan, Madonna, and Michael Milken for the 1980s. For the 1970s, the same person wins every time: John Travolta.

Here and there in this engaging history of the period, Mr Schulman seems to share this unflattering view, writing of a "gaudy, depressing" decade and lamenting its "sometimes cheesy popular culture". But his approach is for the most part positive—and revisionist. Strictly speaking, he covers the late 1960s to the mid-1980s, treating this as a "long decade" in which underlying social and cultural change transformed American politics. In his view, the populist conservatism that emerged as a major force in these years reflected two deeper trends: a third great religious awakening—following the tumultuous revivals of faith in the mid-18th and early 19th centuries—and the growing dominance of sunbelt values. Culturally, the period consolidated a profound and lasting anti-authoritarianism not confined to left or right, or indeed to any one distinctive grouping: the peace sign of the 1960s was replaced quite generally in the 1970s by a "single upturned middle finger".

The long 1970s, he argues, led people to seek individual self-improvement and exalt private, non-governmental institutions. Americans engaged enthusiastically in what Tom Wolfe called "plugging in"—breaking away from conventional society and losing themselves in spiritual worlds of their own. Hal Lindsey's apocalyptic fantasy, "The Late Great Planet Earth" (1970), became wildly popular. Millions of Americans embraced new-age passions such as zen and yoga, alternative therapies and new religious callings.

Mr Schulman uses changes in popular music as a way to highlight larger cultural and political trends. He makes much of the rise in the popularity of country music—a manifestation, as he sees it, of the power shift to the sunbelt. Along the way, he reveals his own musical preferences, which include a liking for disco, an oft-maligned but cosmopolitan form that attracted all kinds of people and offered an outlet, socially and musically, for disenfranchised groups. He finds that later music—rap, for instance—reflected a weakening of disco ideals of racial and ethnic integration. The phenomenal success of "Roots" on television in 1977 is for him another symptom of the quest for group identity that marked the growing segmentation of American life.

"The Seventies" is far from comprehensive. Slighting foreign policy, it ignores the Iranian hostage crisis in 1979-80 that so badly damaged the presidency of Jimmy Carter. (Ronald Reagan's foreign policies receive more attention than Mr Carter's.) The Supreme Court seems not to have mattered. Glum about the appeal of conservatism, Mr Schulman focuses on the concerns of young liberals and radicals who, like the author, grew up in the 1970s. President Richard Nixon gets a thorough bashing; sexually liberated feminists receive extended, more flattering coverage.

The chief historical claim of this short, sprightly book—that the 1970s undid the liberal 1960s and installed an enduring conservatism—is debatable. Americans, deeply distrusting the state, have always been ideologically conservative in that sense. They were no different in the 1970s, and are no different now. But neither then nor later, as conservatives in Washington have discovered, often to their dismay, was it possible really to dismantle the New Deal or the Great Society. Many Americans talk a conservative game while insisting on the preservation of subsidies, laws and regulations that benefit

them. If Mr Schulman had devoted more space to the often successful work of liberal federal officials and judges during the 1970s, he might have arrived at a different conclusion: that the politically liberal 1960s, not the conservative 1970s, remain the decade that set the stage for much that Americans are still fighting over. Mr Schulman's sub-title notwithstanding, the claim that the 1970s marked a "great shift in American culture, society and politics" will be contested.

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Indian biography

Skin deep

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ONE good argument for popular biography is that it makes history palatable for people who dislike dates and find history's impersonal forces bland. Biographies of two Indian leaders whose careers spanned most of the 20th century and did much to shape it should tell readers much of what they might want to know about modern India. On that score, these books disappoint.

These were epoch-making lives. Mahatma Gandhi (1869-1948) was a saint-genius who turned opposition to British rule into a mass movement and demonstrated, through non-violent protest, that virtue has its own inescapable power. Indira Gandhi (1917-84), who was no relation to the Mahatma but the daughter of India's first prime minister, Jawaharlal Nehru, put her baleful stamp on India in two times as prime minister, in 1966-77 and 1980-84. She tested its first nuclear device and tightened the state's grip over the economy. Her brief imposition of dictatorship was the culmination of policies that lastingly weakened India's institutions and regions and promoted rule by dynasty.

These giants seem to illustrate the cliché that India is a land of polarities: the Mahatma ("great soul") held India to impossible ideals; Madam (as women in authority are called) imposed on it a bleak reality. Yet merely to sketch their lives is to introduce complications. The Mahatma could be staggeringly callous towards his family. He tested his chastity by sleeping naked with young women, a practice that might provoke lawsuits today.

GANDHI'S PASSION: THE LIFE AND LEGACY OF MAHATMA GANDHI
By Stanley Wolpert

Oxford University Press; 308 pages; $27.50 and £20.

Buy it at
Amazon.com
Amazon.co.uk

INDIRA: THE LIFE OF INDIRA NEHRU GANDHI
By Katherine Frank

HarperCollins; 588 pages; £19.99.

Buy it at
Amazon.com
Amazon.co.uk

His signature was political behaviour at once shrewd and sublime. When India became independent in 1947 (and lost eastern and western wings to Pakistan) the Mahatma was in Calcutta, living under the same roof as the Muslim politician blamed for inciting murder of the city's Hindus, a gesture that temporarily quelled communal passions. Equally characteristic was otherworldliness bordering on fantasy. He tried the patience of more practical and straightforwardly ambitious politicians like Nehru, for example by proposing Muhammad Ali Jinnah, Pakistan's would-be leader, as India's first prime minister, to avert partition.

Indira was the rather ordinary daughter of an extraordinary man who seemed befuddled by power. Katherine Frank writes that "history was not going to remember Indira Gandhi for any one thing—for a coherent strategy, ideology, policy or vision." Yet she had mahatmaic sparks of greatness. In disgrace after her first disastrous term in office she recaptured popular affection, and eventually her office, with the sort of theatre of which the Mahatma was the master. She rushed to the scene of a massacre of harijans (once untouchables) in Bihar by jeep, tractor and, finally, elephant, while the government in Delhi dithered.

India's polarities killed both protagonists: the Mahatma was shot by a Hindu fanatic enraged by his solicitude towards Muslims, Indira by her Sikh bodyguards, provoked by an attack she authorised on Punjabi separatists who had seized Sikhism's holiest site.

Neither biography pans out from its subject to broader issues that only economics and sociology can explain. Even psychology is kept on the periphery. These books thus suggest mysteries that are barely investigated, let alone solved. What were the roots of the Hindu-Muslim conflict that led to India's partition? Why were India's industrialists such faithful backers of the austere Mahatma? Why was Indira Gandhi, daughter of a committed enemy of the British empire, welcomed by such establishment institutions as Badminton school and Oxford? The conflicts in the characters of the two leaders are described, but not adequately explained.

Though it admits the Mahatma's failings, Mr Wolpert's book verges on hagiography, which is

disappointing in a life of such a historical figure. The most detailed—and as it turns out the most provocative—parts of Miss Frank's book on Indira are about her personal life, including rumoured affairs. She sheds light on her family and on her marriage to Feroze Gandhi, a charismatic lout. She mentions but does not endorse an old story that he had once had an affair with her mother. Ms Frank's unabashed handling of these private matters has upset certain Indian readers, some of whom want the book banned.

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City gardens

Patches of green

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THE LONDON TOWN GARDEN 1700-1840.
By Todd Longstaffe-Gowan.
Yale; 289 pages; £30

WHEN he arrived in Britain from Panama at the age of 13, Todd Longstaffe-Gowan took a train from London to Edinburgh. He was intrigued by the rows of houses along the railway, each with its idiosyncratic patch of outdoor space. Perceptively, he recognised that these “private sanctuaries...full of the intimate realities of life”, provided clues to the nature of the country with which he was about to become acquainted. That train journey sparked an interest that has culminated in this comprehensive and beguilingly illustrated labour of love and wide research. (A show called “London Town Gardens” accompanies publication and is at The Museum of London until April 30th.)

Until the 17th century, gardening in London was largely confined to the grounds around the mansions of the nobility that ringed the narrow streets of the city itself. There, the landowners had the space and the inclination to replicate the gardens of the country houses that they regarded as their natural habitat. Only when the city grew, and the middle classes built on smaller plots, did town gardening become a distinctive craft. One of its pioneers was Thomas Fairchild, who in 1722 wrote the first book on gardening in London, championing private gardens, leafy squares and public parks, and identifying plants that would survive in the smoke of the city.

Not everyone was convinced that gardening in so cramped a setting was worth the effort. In 1756 Isaac Ware, an architect, wrote that it was “very idle” to try to grow flowers in the city: better to pave over the whole backyard and be done with it. But the sceptics underestimated the native passion of the English for cultivated ground of their own. Nurserymen and garden designers proliferated and flourished. Conservatories and greenhouses were developed to defeat the weather. Ideally, an upwardly mobile Londoner would seek a house looking out on to a verdant square, with a stylish garden at the back. The town garden, Mr Longstaffe-Gowan observes, was “perfectly attuned to the advent of conspicuous consumption.” Today’s garden-design magazines, garden manuals and garden-makeover programmes for television amply confirm that it remains so.

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Modern communications

Wish you were here

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THIS is an update of “The Death of Distance”, the author’s wide-ranging review of the impact of the communications revolution on work and play. Written in 1997, the earlier book missed the wild excitement (and the subsequent disappointment) that the Internet engendered in the closing years of the 20th century.

THE DEATH OF DISTANCE 2.0: HOW THE COMMUNICATIONS REVOLUTION WILL CHANGE OUR LIVES
By Frances Cairncross

Harvard Business School; 336 pages; $24.95 ($16.95 paperback). Texere; £14.99

Buy it at
Amazon.com
Amazon.co.uk

Particularly valuable in this edition is the new material that Frances Cairncross, the management editor at *The Economist*, has added on what she (rightly) says will be the big impact of the Internet in this decade: “on existing companies, revolutionising the way they do business”. She cites the example of Cisco Systems, which reckons it saved itself 250,000 telephone calls and 17% of its operating costs by setting up a website to provide its customers with technical back-up. Inevitably, though, in such a fast-moving field, the story has moved on even before the book has been published. The California court ruling, for example, that forced Napster to rewrite its business plan for downloading copyrighted music files has to await “The Death of Distance 3.0”.

Also welcome is the extra attention the author gives to the concerns of those who are less than full-blooded enthusiasts for the communications revolution—those, for example, who worry about what she calls the “Five Ps” of the Internet: policing, pornography, privacy, protection and property. And those who fear the monopolistic tendencies of the industry, as revealed by the anti-trust charges against Microsoft. “Competition”, she says, “clearly does not come naturally in communications.”

But Ms Cairncross remains bullish. “The communications revolution almost certainly is raising productivity,” she concludes after considering the American experience of recent years. And, she argues, it is having a beneficial effect on government, leading gradually to increased efficiency and greater accountability. What the book fails to address satisfactorily, though, is how the death of distance does not seem to have made us feel significantly closer. So many new ways to communicate; yet still so few ways to connect.

TIM HINDLE

Our policy is to identify the reviewer of any book by or about someone closely connected with *The Economist*

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Garden design

Power plants

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From The Economist print edition

FOR most of the first half of the 20th century, Europeans had other things on their minds than gardening. Two great wars, social upheaval and sharply increased labour costs were the undoing of numerous splendid gardens. Several of these have been restored to something approaching their former glory by national conservation bodies like English Heritage, often as an afterthought to the restoration of grand houses that they commonly embellish. Only in a very few cases has tradition been cast aside and the opportunity seized to create an uncompromisingly modern garden on the skeleton of the old.

This is what the Duchess of Northumberland is attempting in the 12-acre (5-hectare) garden of the family seat at Alnwick castle, close to the Scottish border. She has engaged a 76-year-old Belgian designer, Jacques Wirtz, and his two sons, Peter and Martin, to create a £14m ($20m) showpiece, with tunnels of hedges and cascades of water, that she immodestly dubs “Britain’s answer to the 17th-century splendour of Versailles”. She hopes it will make north-east England a mecca for garden-lovers, alongside the existing attractions of Wallington, Belsay and Cragside.

For many years, the Wirtzs remained something of a secret among garden designers. The patriarch, who was born in Antwerp in 1924 and studied landscape architecture in Vilvoorde during the second world war, founded the company in 1948. His first commissions were for small residential gardens. Only later did the call come to design public parks, housing complexes and university campuses. Highly structured, Mr Wirtz’s work is distinguished by a clearly- contoured, geometrical quality that is as effective in winter as it is in summer. You won’t see granite, steel or glass—the usual post-modernist pot pourri—in a Wirtz garden. Instead, he will use water for effect, or avenues of pleached hornbeams and clipped yew hedges, the better to lead and surprise the garden explorer. “The plant material always plays the first violin,” says Peter Wirtz, who is overseeing the Alnwick project. “We search for the tranquil spirit, never for conflict.”

Architecture transcends frontiers, yet garden design has always been more parochial and this is the first time that the Wirtzs have worked on a British garden, despite their formidable reputation in continental Europe. After more than two decades in the business, the breakthrough came in 1970 when Mr Wirtz was asked to design the garden of the Belgian pavilion at the Osaka World Exposition and an entire new campus for the University of Antwerp. Later, the Wirtzs’ renovation of the gardens of the Elysée palace and the Carrousel of the Tuileries in Paris, with its sunburst pattern of radiating yew hedges, won them international acclaim. Three new commissions—for the landscaping of the tiny new Jewish cemetery in Geneva, the gardens around David Chipperfield’s new law court in Salerno and a small garden in London’s Canary Wharf—will make them better known when they are completed over the next two or three years, as will a series of new private gardens in Los Angeles, Chicago and Florida. Yet most of the Wirtzs’ work is to be seen around their home base at Antwerp, where they have created numerous effective public spaces and private gardens, notable for their sensitivity to the existing landscape and its history.

That was what persuaded the duchess to invite them to submit a design for the huge walled garden at Alnwick, arrestingly set on a slope some 300 yards (270 metres) from the castle itself. Created in the 18th century and substantially altered in the 19th, it had been used for much of the last 50 years as a nursery for a local tree grower, and part had been paved over as a car park. Only when masses of laurel and other overgrowth had been cleared was it possible to see the sinuous line of the man-made earth banks that anchored the design that was made in the 1850s.

The Wirtzs have used these as the starting-point for their own scheme. It is dominated by a huge central cascade whose curved edges relate to the line of the earth banks: the duchess was convinced from the start that the sloping site, with two springs at its foot, demanded that water should be a key component of the design. Almost surrounding the cascade will be a spectacular hedge made of parallel rows of beeches joined at the top to form a tunnel that can be walked through, with windows cut out of the sides like arrow slits in a castle wall.

The project began in 1996 when Ralph Percy inherited the dukedom from his elder brother and moved the family into the castle. The new duchess, with a passion for gardening that goes back to her childhood, took over responsibility for the garden and decided to do something dramatic with it. “As soon as I saw it I knew it was an extraordinary site,” she recalls. “It’s beautiful, quite magical.” At first she thought of designing it herself, but the tremendous scale persuaded her to call in professional help. She consulted several British designers, only to find that they did not respond sympathetically to her over-arching vision and were too inflexible to accommodate it. “I’m sorry, Jane, we’re not going to allow you to have a rose garden,” said one, who was soon on the train south.

Then a European friend invited her to meet continental designers. “Their attitude was so refreshing,” she recalls. “They listened to what I was saying and they had really good, new exciting ideas that I just hadn’t come across when I met people in this country.” But she has engaged a British firm of water technologists, after discovering that the elaborate plans of the American company she approached first would have lifted the cost of the project to £23m. Although construction was then hampered by atrocious winter weather, much of the infrastructure is in place and some of the 65,000 trees and plants have begun to arrive. The duchess is confident that the garden will be ready for visitors by October. Phase two, which involves more complex water technology, will take longer, and will need to attract well-endowed sponsors.

The duchess had to battle for planning consent to create this modern garden within ancient walls in the grounds of a grade-one listed building. At first she was told that she would have to restore what was there. She replied to the planners that she could do something better. This was taken as arrogant, she says, and people have asked her how she will feel when a younger generation changes it all again. It won’t bother her, she insists: “The idea of a garden sitting stagnant for 100 or 200 years is not what I consider gardening is all about.”

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Italy's new literary parks

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A nobly intentioned foundation in Naples has come up with the idea of literary parks to be sponsored across Italy by tourist boards and private supporters. Pliny has lent his name to a park near Mount Vesuvius and Giuseppe Tommasi di Lampedusa (right), the author of "The Leopard", to one near Palermo. Norman Douglas (1868-1952), a Scottish-Austrian writer noted for "South Wind", a novel, and for accounts of his back-country travels through the Mezzogiorno, is the only foreigner to be honoured with a park of his own—in his beloved Calabria, of course.

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What has work become?

Apr 5th 2001
From The Economist print edition

Four recent books examine how economic forces have changed the nature of work and success

WHITE-COLLAR SWEATSHOP: THE DETERIORATION OF WORK AND ITS REWARDS IN CORPORATE AMERICA.
By Jill Andresky Fraser.
Norton; 288 pages; $26.95

THIS is an alarming account by a journalist, Jill Andresky Fraser, of the plight of American office workers. She has interviewed a wide sample of America's "cubicle-dwellers"—corporate white-collar employees below the level of senior management. They complain of job insecurity, low pay rises, overwork and "job spill" as e-mail and voice-mail pursue them after work, eroding out-of-office life with family, friends and community.

Hers is a disturbing picture. But is it representative? As you read on into her horror stories, an unanswered question begins to repeat itself: if the corporate life is so awful—if grown, responsible people really go in terror of bosses nicknamed "Chainsaw" and "Neutron Jack"—why do so many put up with it? Some cite as reasons paying university fees or simply making more money. But if office tyranny is as severe as suggested, these hardly seem adequate explanations of why more do not revolt.

A WORKING NATION: WORKERS, WORK, AND GOVERNMENT IN THE NEW ECONOMY.
By David T. Ellwood, Rebecca M. Blank, Joseph Blasi, Douglas Kruse, Karen Lynn-Dyson and William A. Niskanen.
Russell Sage Foundation; 162 pages; $29.95 ($16.95 paperback)

IN FACT, as this collection of papers reports, the satisfaction that Americans take in their jobs has hardly changed over the past 30 years. The authors are economists or public-policy specialists, some with experience in the Reagan or Clinton administrations. They rely on statistics and survey data rather than anecdotes.

Although it does not bear out the notion of a terrorised and depressed middle class, theirs is not a complacent picture. With America's astonishing two-decade boom came, as the authors show, wider inequality in incomes, higher job turnover and more temporary work. They suggest how the low-skilled workers left behind might be helped by further reforms in the labour market as well as by better education and training. They also compare the American and European experiences. For readers interested in labour issues, this collection makes a good primer.

THE FUTURE OF SUCCESS.
By Robert B. Reich.
Knopf; 304 pages; $26.
Heinemann; £12.99

ROBERT REICH, an ex-secretary of labour, shares his own thoughts on work and its rewards. He sees America as a great forcing house of innovation that can provide anything you want at the best possible price—but at personal cost. Career- and company-hopping are now common; pay spreads have widened and jobs less secure; people feel they are working harder than ever and are "out-sourcing" many home tasks. To succeed in this meritocratic race, you need talent, ingenuity, salesmanship and connections. You can choose not to join in, Mr Reich concludes; and you may be happier, though poorer, by staying out. But success at the game will demand punishing hours and unremitting hustle. There is in his view no middle way.

BLOOD, SWEAT AND TEARS: THE EVOLUTION OF WORK.
By Richard Donkin.
Texere; 356 pages; $27.95 and £18.99

RICHARD DONKIN, a journalist, has written an ambitious, wide-ranging history of the changing nature of work, and not just in America. He delves into the presumed work life of early man, into slave society and medieval guilds. He ponders the origins of the Protestant work ethic, under which, as he tells it, work became an end in itself, and contrasts this with the later utilitarian emphasis on the fruits of labour—consumption and wealth. He also sketches modern theories of industrial and clerical work due to such diverse thinkers as W.E. Deming, Frederick Taylor and Max Weber.

Coming to our own day, Mr Donkin regrets the hectic demands of the workplace and wonders how the old idea of work as its own reward can be reconciled with the need to earn a living. You may well question whether work was ever as self- rewarding as this contrast suggests. Yet the distinction between job-satisfaction and pay packet is one we can all recognise. Mr Donkin's hope is that a new kind of company will in future blur the line between work and leisure, making labour in essence a form of fun. It is an ancient dream, and an attractive one. But it smacks more of Eden than the real world.

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David McTaggart

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David McTaggart, founder of Greenpeace, died on March 23rd, aged 68

Reuters

THE South Pacific had a fascination for David McTaggart, as it has done for many westerners. Tahiti, New Caledonia, Tonga: he bought a boat, the *Vega*, and sailed from one evocative landfall to another. In 1972 he heard of, or maybe read about, an organisation called Don't Make a Wave. It was protesting about French nuclear tests on the island of Mururoa. France had tested its first bombs in the Sahara desert, but in 1966 it had moved its nuclear test site to the more distant Mururoa, an uninhabited island that is part of French Polynesia.

Although Mururoa is remote, nuclear watchers were worried that the French tests were above ground, potentially polluting the atmosphere for many hundreds of miles beyond its shores. The United States had ended tests in the atmosphere in 1962, and the Soviet Union in 1963. Now here was France nine years later continuing to send poisonous mushrooms into the Pacific skies.

It is not clear if Don't Make a Wave, a small group of enthusiasts, intended more than a signal to the world about what the French were up to. But in Mr McTaggart they found they had recruited a warrior. When the next test was reported to be imminent, he set out from Tahiti, about 960km (600 miles) from Mururoa, in the 36ft *Vega* and hove-to downwind from the expected explosion. The French had taken great trouble to clear the seas around Mururoa and tried to persuade Mr McTaggart to sail away. He declined. They postponed their test, then rammed the yacht. It was damaged but still seaworthy, and Mr McTaggart hobbled back to Tahiti. Next year he returned to Mururoa. This time French commandos boarded the boat and beat him up. In 1974 Mr McTaggart won damages in a French court. The same year France ended atmospheric tests, instead exploding nuclear devices underground in Mururoa. Mr McTaggart became, if not world famous, certainly a leading figure in the fraternity of those opposed to mucking up the planet. He took over Don't Make a Wave, and gave it rebirth as Greenpeace.

War and peace

David McTaggart was a Canadian and, as his name suggests, of Scottish descent. His family, he once said, practised the teachings of John Calvin (1509-64), a Protestant fundamentalist highly influential in Scotland. Not only was Mr McTaggart stubborn, but he tended to be intolerant of anyone who opposed him. In a war he would have done well or had a hero's death. He had to make do with the conflicts of peace.

He first took on the French when he was 40, convinced that this was what he was born to do: Calvinists believe in predestination. All that had gone before in his life, keeping himself fit (he was three times Canada's badminton champion), gaining business experience as a property developer in the United States, were matters preparing him for the big thing. When he started with Greenpeace there were already many thousands, possibly millions, of people concerned about dangers to the environment and trying to do something about them, either as individuals or in small groups. Mr McTaggart worked to bring together all these well-meaning people into one massive international pressure group as professionally organised as those they sought to humiliate.

Their raw material was publicity, much of it gained by derring-do exploits of Greenpeace's front-line "soldiers". Mr McTaggart would be first over the top. He continued his war with the French over nuclear testing, again visiting Mururoa. The angry French retaliated in 1985 by blowing up a Greenpeace ship, *Rainbow Warrior*, in Auckland harbour, killing one person aboard. Greenpeace mourned the loss, but gained comfort from the worldwide condemnation of the French. Under Mr McTaggart's leadership, *Forbes* magazine noted acidly, Greenpeace mastered the tools of "image manipulation".

A problem Greenpeace eventually faced was that it grew so big as to risk becoming unwieldy. Its accounts for 1999 show a world-wide gross income of $134m. Mr McTaggart always sought to promote it as the brave struggling group of its early days. A newspaper picture of young idealists in rubber boats foiling whalers or climbing an oil rig to warn of pollution was what kept the public sympathetic. But eventually he tired of the giant he created. In 1991 he gave up the chairmanship and bought a farm in Italy and produced olive oil: organic, of course. He occasionally returned to the fray, most recently in 1995, with yet another trip to Mururoa. He died in a car crash near his home in Umbria.

Perhaps curiously, not a lot is known about David McTaggart. He obviously could not help becoming associated with Greenpeace's exploits, but he turned down requests for interviews. Little detail has emerged about his personal life. He had a son, but stories that he was married three times and had four daughters have not been confirmed. His speech was far from elegant, and much punctuated by expletives. No one who knew him can recall any stirring phrases. He would listen to a lieutenant's plans for a new exploit and, if he approved, tell him to get on with it. "I have a natural love of brevity," wrote John Calvin.

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OUTPUT, DEMAND AND JOBS

Apr 5th 2001
From The Economist print edition

Denmark's GDP grew by 1.1% in the year to the fourth quarter of 2000. In February, unemployment fell to 4.7% in Japan and to 8.8% in France. Germany's jobless rate was 9.3% in March. Growth of industrial production slowed to 1.2% in Canada and 9.4% in Sweden in the 12 months to January; but it jumped to 9.3% in Austria.

% change at annual rate	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)	Unemployment % rate	
	3 mths†	1 year	2001	2002	3 mths†	1 year	1 year	latest	year ago
Australia	− 2.2	+ 2.1 Q4	+ 2.3	+ 3.9	+ 0.8	+ 3.1 Q4*	− 0.1 Q4	6.9 Feb	6.7
Austria	+ 1.2	+ 1.9 Q3	+ 2.3	+ 2.5	na	+ 9.3 Jan*	− 1.3 Dec	3.7 Feb	3.6
Belgium	+ 4.9	+ 3.1 Q4	+ 2.6	+ 2.7	na	+ 6.7 Jan*	+ 5.0 Dec	10.3 Mar*	10.6
Britain	+ 1.4	+ 2.6 Q4	+ 2.4	+ 2.7	− 1.8	+ 1.0 Feb	+ 5.8 Feb	5.2 Jan‡	5.9
Canada	+ 2.6	+ 4.0 Q4	+ 2.2	+ 3.3	− 1.2	+ 1.2 Jan	+ 3.9 Dec	6.9 Feb	6.8
Denmark	+ 4.9	+ 1.1 Q4	+ 1.9	+ 2.2	na	+ 4.3 Jan	− 1.0 Dec	5.3 Jan	5.4
France	+ 3.9	+ 2.8 Q4	+ 2.6	+ 2.7	+ 2.5	+ 2.9 Jan	+ 1.4 Jan	8.8 Feb	10.2
Germany	+ 0.8	+ 1.9 Q4	+ 2.1	+ 2.6	+ 3.9	+ 7.1 Jan	+ 4.8 Jan	9.3 Mar	10.1
Italy	+ 3.2	+ 2.7 Q4	+ 2.2	+ 2.5	+ 6.8	+ 9.6 Jan	− 1.0 Jan	9.9 Jan	11.2
Japan	+ 3.2	+ 2.8 Q4	+ 0.5	+ 1.3	− 3.6	− 2.1 Feb	+ 1.8 Jan	4.7 Feb	4.9
Netherlands	+ 5.1	+ 3.1 Q4	+ 2.9	+ 3.1	+ 8.6	+ 9.4 Dec	+ 2.9 Nov	2.4 Feb§	2.8
Spain	+ 2.9	+ 3.7 Q4	+ 3.0	+ 3.3	+ 0.6	+ 4.7 Jan	na	13.7 Feb	15.0
Sweden	+ 2.4	+ 2.6 Q4	+ 2.7	+ 3.0	na	+ 9.4 Jan	+ 4.9 Jan	4.2 Feb*	5.4
Switzerland	+ 1.8	+ 2.5 Q4	+ 2.0	+ 2.2	na	+ 5.0 Q4*	− 2.0 Dec	1.9 Feb*	2.4
United States	+ 1.1	+ 3.4 Q4	+ 1.4	+ 3.0	− 4.7	+ 1.2 Feb	+ 2.3 Jan	4.2 Feb	4.1
Euro area	+ 2.8	+ 3.0 Q4	+ 2.4	+ 2.7	+ 6.6	+ 5.1 Jan	+ 1.7 Dec	8.7 Feb	9.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Finland	+ 3.0	+ 5.5 Q4	na	na	+ 2.6	+ 6.7 Jan	+ 4.3 Dec	9.8 Feb*	11.3
Greece	na	+ 2.5 2000	na	na	na	+ 3.1 Nov	+ 6.0 Nov	na	na
Iceland	na	+ 4.4 1999	na	na	na	+ 4.2 1999	na	1.3 Dec	1.7
Ireland	+21.5	+12.2 Q2	na	na	na	+32.2 Jan	+ 7.7 Jan	3.6 Feb	4.5
Luxembourg	na	+ 8.5 2000	na	na	na	+ 0.6 Dec*	+ 9.4 Nov	2.8 Jan	2.6
New Zealand	+ 2.2	+ 1.6 Q4	na	na	na	+ 2.7 Q3*	+ 7.3 Q4	5.6 Q4	6.3
Norway	+ 0.2	+ 0.9 Q4	na	na	+ 3.5	− 0.3 Jan	− 0.5 Jan	3.1 Q4	3.2
Portugal	+ 5.1	+ 3.4 Q3	na	na	na	− 0.3 Jan*	+ 4.6 Jan	3.8 Q4	4.1

*Not seasonally adjusted. †Average of latest 3 months compared with average of previous 3 months, at annual rate. ‡Nov-Jan; claimant count rate 3.4% in February. §Dec-Feb.

Text refers only to the first 16 countries listed

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COMMODITY PRICE INDEX

Apr 5th 2001
From The Economist print edition

The outbreak of foot-and-mouth disease (FMD) in Britain and now continental Europe is playing havoc with agricultural markets. Bars on movements of livestock have meant that fewer animals make it to market. Demand for animal feed in Britain has risen sharply; although infected animals are being culled, uninfected ones kept on farms still need to eat. Export firms are suffering as well, since many countries have stopped importing European meat and grain. Consumers are finding alternatives. The sterling price of New Zealand lamb has risen by 28% since mid-February and is now at a four-year high; American pork-belly futures have climbed by 30% during the same period on speculation that FMD will hit Denmark.

1995=100	Mar 27th	Apr 3rd*	% change on one month	% change on one year
Dollar index				
All items	69.4	68.2	– 5.1	– 8.4
Food	68.6	67.3	– 5.7	– 7.3
Industrials				
All	70.5	69.3	– 4.3	– 9.9
Nfa†	65.8	65.2	+ 0.9	– 12.5
Metals	74.5	72.9	– 7.9	– 7.8
Sterling index				
All items	76.2	75.3	– 2.4	+ 2.4
Food	75.3	74.4	– 3.0	+ 3.7
Industrials	77.4	76.6	– 1.6	+ 0.8
Euro index				
All items	102.2	101.1	– 0.4	– 1.4
Food	101.1	99.8	– 1.0	– 0.2
Industrials	103.8	102.8	+ 0.4	– 3.0
Yen index				
All items	91.0	91.3	+ 0.5	+ 9.1
Food	90.0	90.2	– 0.1	+ 10.5
Industrials	92.4	92.9	+ 1.4	+ 7.4
Gold				
$ per oz	262.10	257.25	– 1.4	– 7.3
Crude oil North Sea Brent				
$ per barrel	25.90	24.61	– 7.5	+ 3.3
West Texas Intermediate				
$ per barrel	27.51	26.63	– 6.5	+ 5.6

* Provisional. † Non-food agriculturals.

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ECONOMIC FORECASTS

Apr 5th 2001
From The Economist print edition

Every month *The Economist* surveys a group of economic forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest forecasts of growth. The previous month's forecasts, where different, are shown in brackets. This month our panellists have become notably gloomier about Japan's economic prospects; they halved their average prediction for GDP growth in 2001 to just 0.5%. Forecasts of growth this year have also been lowered sharply for Australia, Canada, Germany and Sweden. Expected American growth in 2001 has been cut again, to only 1.4%. Forecasts of growth in America and the euro area in 2002 have also been trimmed.

The Economist poll of forecasters, April averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2001	2002	2001	2002	2001	2002	2001	2002
Australia	1.3/3.5	3.0/5.2	2.3 (3.0)	3.9 (4.0)	3.5 (3.9)	2.3 (3.0)	–3.0 (–3.4)	–3.2 (–3.6)
Austria	1.8/2.9	2.0/2.9	2.3 (2.4)	2.5 (2.7)	1.8 (1.7)	1.4 (1.7)	–2.4	–1.9 (–2.0)
Belgium	2.3/3.1	2.0/3.1	2.6 (2.7)	2.7 (2.8)	1.9 (2.0)	1.8 (1.9)	4.0 (4.2)	4.0 (4.2)
Britain	2.1/2.8	2.3/3.3	2.4 (2.5)	2.7 (2.8)	2.0 (2.2)	2.3 (2.5)	–2.0 (–1.9)	–1.9 (–1.6)
Canada	1.0/3.2	2.0/4.2	2.2 (2.6)	3.3 (3.5)	2.3 (2.4)	2.0 (2.2)	1.1 (0.6)	0.9
Denmark	1.5/2.4	1.7/3.0	1.9 (2.0)	2.2	2.3	2.2 (2.3)	1.4	1.4
France	2.3/2.9	2.3/3.1	2.6	2.7 (2.9)	1.4	1.4 (1.5)	1.9	1.8 (1.9)
Germany	1.7/2.7	2.3/2.9	2.1 (2.4)	2.6 (2.8)	1.8 (1.7)	1.3 (1.5)	–1.3 (–1.2)	–1.1 (–1.0)
Italy	1.6/2.5	1.5/3.1	2.2	2.5 (2.6)	2.3 (2.2)	1.9 (2.0)	–0.3 (–0.2)	nil (–0.1)
Japan	–0.8/1.5	0.4/2.7	0.5 (1.1)	1.3 (1.7)	–0.5 (–0.4)	–0.3	2.2 (2.3)	2.2 (2.3)
Netherlands	2.5/3.3	2.4/4.0	2.9 (3.1)	3.1 (3.3)	3.6 (3.2)	2.3	3.9	3.9 (4.2)
Spain	2.4/3.4	2.7/4.0	3.0 (3.1)	3.3 (3.5)	3.0 (2.9)	2.4 (2.7)	–2.9 (–3.1)	–2.6 (–3.1)
Sweden	2.0/3.1	2.6/3.8	2.7 (3.1)	3.0 (3.3)	1.6 (1.7)	1.7	2.1	2.1 (2.0)
Switzerland	1.7/2.7	1.6/2.8	2.0 (2.2)	2.2 (2.4)	1.2 (1.4)	1.3	11.8	11.2 (11.3)
United States	nil/2.3	1.5/3.8	1.4 (1.6)	3.0 (3.4)	2.8 (2.6)	2.2 (2.3)	–4.3	–4.1 (–3.9)
Euro area	2.2/2.6	2.3/3.3	2.4 (2.5)	2.7 (2.9)	2.0 (1.9)	1.6 (1.8)	–0.2	–0.1 (–0.2)

Sources: ABN Amro, Deutsche Bank, EIU, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan, Morgan Stanley Dean Witter, Nordbanken, Decision Economics, Royal Bank of Canada, Salomon Smith Barney, Scotiabank, Shinsei Bank, Warburg Dillon Read.

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PRICES AND WAGES

Apr 5th 2001
From The Economist print edition

Japan's consumer prices fell by 0.1% in the 12 months to February. Over the same period, producer-price inflation slowed to 4.4% in the euro area and to 2.6% in Canada. Workers in Japan received a pay rise of 0.7%, a real gain of 0.8%. Those in the Netherlands won wage increases of 3%—seemingly generous, but a pay cut of 1.4% in real terms.

% change at annual rate	Consumer prices*		The Economist poll consumer prices forecast		Producer prices*		Wages/earnings	
	3 mths†	1 year	2001	2002	3 mths†	1 year	3 mths†	1 year
Australia	+ 1.2	+ 5.8 Q4	+ 3.5	+ 2.3	+10.2	+ 8.4 Q4	– 3.3	+ 5.0 Q4
Austria	na	+ 2.6 Feb	+ 1.8	+ 1.4	– 1.1	+ 2.6 Feb	+ 5.4	+ 2.6 Feb
Belgium	+ 0.8	+ 2.1 Mar	+ 1.9	+ 1.8	– 3.5	+ 5.4 Jan	+ 3.7	+ 1.6 Q4
Britain	– 0.1	+ 2.7 Feb	+ 2.0	+ 2.3	– 1.5	+ 1.6 Feb	+ 7.5	+ 4.4 Jan
Canada	+ 0.7	+ 2.9 Feb	+ 2.3	+ 2.0	– 0.9	+ 2.6 Feb	– 3.0	+ 1.7 Dec
Denmark	+ 0.5	+ 2.4 Feb	+ 2.3	+ 2.2	– 4.6	+ 3.4 Feb	+ 3.0	+ 3.6 Q4
France	– 0.5	+ 1.4 Feb	+ 1.4	+ 1.4	+ 0.5	+ 3.6 Jan	+ 4.6	+ 5.3 Q3
Germany	+ 4.3	+ 2.5 Mar	+ 1.8	+ 1.3	– 1.5	+ 3.7 Feb	na	+ 2.4 Jan*
Italy	+ 3.4	+ 2.8 Mar	+ 2.3	+ 1.9	+ 1.6	+ 4.9 Feb	+ 0.9	+ 1.8 Jan*
Japan	– 0.8	– 0.1 Feb	– 0.5	– 0.3	+ 2.7	+ 0.1 Feb	na	+ 0.7 Feb
Netherlands	+ 2.6	+ 4.5 Feb	+ 3.6	+ 2.3	– 0.9	+ 5.3 Feb	+ 2.3	+ 3.0 Feb
Spain	+ 3.0	+ 3.8 Feb	+ 3.0	+ 2.4	– 0.6	+ 3.6 Feb	+ 1.9	+ 2.2 Q4
Sweden	na	+ 1.6 Feb	+ 1.6	+ 1.7	+ 0.6	+ 2.5 Feb	+ 3.7	+ 2.6 Dec*
Switzerland	– 0.1	+ 0.9 Mar	+ 1.2	+ 1.3	– 2.0	+ 0.8 Feb	na	+ 0.2 1999
United States	+ 3.7	+ 3.5 Feb	+ 2.8	+ 2.2	+ 5.1	+ 4.0 Feb	+ 4.7	+ 4.1 Feb
Euro area	+ 1.6	+ 2.6 Feb	+ 2.0	+ 1.6	– 0.2	+ 4.4 Feb	+ 1.2	+ 1.8 Q3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 0.6	+ 3.1 Feb	na	na	– 7.4	+ 3.2 Feb	+ 3.0	+ 4.3 Q4*
Greece	– 0.4	+ 3.5 Feb	na	na	+ 0.9	+ 5.2 Jan	na	na
Iceland	+ 2.3	+ 3.9 Mar	na	na	+10.1	+ 6.0 Mar	+11.0	+ 8.2 Feb
Ireland	+ 1.3	+ 5.3 Feb	na	na	– 1.5	+ 3.5 Feb	+17.5	+ 7.0 Q2*
Luxembourg	+ 1.4	+ 2.9 Feb	na	na	+ 2.5	+ 5.3 Jan	+ 7.7	+ 8.4 Oct*
New Zealand	+ 4.7	+ 4.0 Q4	na	na	+15.0	+10.2 Q4	+ 1.8	+ 1.6 Q4
Norway	+ 4.3	+ 3.6 Feb	na	na	na	+ 3.8 Feb	+ 7.7	+ 4.3 Q4*
Portugal	+ 5.3	+ 4.8 Feb	na	na	+ 4.3	+ 7.3 Jan	na	+ 1.6 Jan*

*Not seasonally adjusted. †Average of latest 3 months compared with average of previous 3 months, at annual rate.

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MONEY AND INTEREST RATES

Apr 5th 2001
From The Economist print edition

Broad-money growth was unchanged in the euro area in the year to February, but narrow-money growth picked up slightly. Money-supply growth in Denmark was again negative. Australia cut its interest rates by half a percentage point.

	Money supply* % rise on year ago			Interest rates % p.a. (Apr 4th 2001)							
				over-	3-mth money market		banks	2-year	10-year gov't		corporate
	narrow	broad		night	latest	year ago	prime	gov't bonds	latest†	year ago	bonds
Australia	+11.3	+ 7.4	Feb	5.00	4.84	6.03	8.50	4.50	5.23	6.27	6.58
Britain	+ 8.4	+ 9.0	Feb	6.58	5.38	6.16	6.75	4.89	4.77	5.14	6.39
Canada	+13.6	+ 6.3	Feb	4.93	4.64	5.27	6.75	4.69	5.43	5.85	7.11
Denmark	– 0.2	– 5.2	Feb§	4.90	4.85	4.06	8.00	4.60	4.96	5.41	7.09
Japan	+ 4.7	+ 2.7	Feb	0.01	0.04	0.04	1.50	0.11	1.28	1.78	1.49
Sweden	+ 3.9	– 0.2	Feb	4.00	3.88	3.99	4.25	3.89	4.69	5.29	4.17
Switzerland	– 2.9	+ 0.9	Feb	3.42	3.30	2.82	5.38	3.05	3.18	3.78	4.02
United States	– 0.7	+10.1	Feb	5.06	4.65	6.22	8.00	4.10	4.93	5.88	7.02
Euro area‡	+ 1.8	+ 4.7	Feb	4.77	4.57	4.00	5.65	4.11	4.70	5.05	5.56

†France 4.84, Germany 4.70, Italy 5.20. Benchmarks: Japan No.230 1.31, US 30-yr 5.50. ‡Germany for prime and bonds. §New series.

*Narrow: M1 except Britain and Sweden M0; broad: M2 or M3 except Britain M4. Sources: Commerzbank, Den Danske, J.P. Morgan Chase, Royal Bank of Canada, Svenska Handelsbanken, Warburg Dillon Read, WEFA Gp, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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TRADE BARRIERS

Apr 5th 2001
From The Economist print edition

Roughly 60 countries, including the European Union's 15 members and the Gulf Co-operation Council's six members, have mechanisms for restricting trade with the rest of the world. That conclusion comes from the annual report of the United States Trade Representative (USTR) on obstacles to American exports. (The report does not analyse America's own, elaborate restrictions.) Of most relevance to countries besides America are anti-competitive practices. The bad news on this front is that Hungary, Peru and Romania have attracted the USTR's attention for their protectionist policies in telephone services, fuel and products previously controlled by state monopolies. On the good side, Norway has reformed its monopsonistic system of buying pharmaceuticals for hospitals. Another negative is in the growing field of electronic commerce; the USTR finds that 52 countries now hamper trade on the Internet, up from 46 last year. Export subsidies could be the next area in which progress is made; most members of the World Trade Organisation want to trim them, especially for farm products.

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TRADE, EXCHANGE RATES AND BUDGETS

Apr 5th 2001
From The Economist print edition

Australia had its biggest trade surplus for nearly four years in February, cutting the 12-month total deficit to $3.6 billion. The trade-weighted Australian dollar appreciated by 0.6% on April 4th after the Reserve Bank's half-point cut in official interest rates boosted investor confidence. In trade-weighted terms, the yen and sterling fell during the week by 3.2% and 0.9%, respectively.

	Trade balance*, $bn		Current account			Exchange rate		Currency units					Budget
	latest month	latest 12 months	$bn latest 12 mths	The Economist poll % of GDP, forecast 2001	2002	trade-weighted† Apr 4th	year ago	per $ Apr 4th	per $ year ago	per £	per euro	per ¥100	balance % of GDP 2000‡
Australia	+ 0.28 Feb	– 3.6	– 15.1 Q4	-3.0	-3.2	69.1	77.1	2.02	1.65	2.90	1.80	1.66	0.9
Austria	– 0.77 Dec§	– 4.6	– 5.0 Jan	-2.4	-1.9	100.5	100.2	15.5	14.3	22.2	13.8	12.7	-1.6
Belgium	+ 0.37 Jan§	+ 12.8	+ 11.6 Dec	4.0	4.0	99.3	98.9	45.4	41.8	65.1	40.3	37.2	-0.1
Britain	– 3.49 Jan	– 42.6	– 24.5 Q4	-2.0	-1.9	105.0	108.9	0.70	0.63	–	0.62	0.57	2.7
Canada	+ 4.19 Jan	+ 37.7	+ 12.7 Q4	1.1	0.9	76.7	81.0	1.57	1.46	2.25	1.40	1.29	2.5
Denmark	+ 0.42 Jan	+ 5.0	+ 2.8 Jan	1.4	1.4	102.3	100.8	8.39	7.71	12.0	7.46	6.88	2.7
France	+ 0.28 Jan	+ 1.1	+ 24.1 Dec	1.9	1.8	102.0	101.7	7.38	6.79	10.6	6.56	6.05	-1.4
Germany	+ 6.19 Jan	+ 53.0	– 25.1 Jan	-1.3	-1.1	99.1	98.5	2.20	2.03	3.16	1.96	1.81	1.4
Italy	+ 0.97 Jan	+ 1.4	– 4.4 Dec	-0.3	nil	72.8	72.6	2,178	2,005	3,124	1,936	1,787	-0.1
Japan	+ 4.99 Jan	+ 111.5	+ 114.0 Jan	2.2	2.2	134.4	154.2	122	105	175	108	–	-6.0
Netherlands	+ 1.49 Jan§	+ 15.2	+ 13.7 Q4	3.9	3.9	98.3	97.7	2.48	2.28	3.56	2.20	2.03	1.6
Spain	– 3.10 Jan	– 39.6	– 17.7 Dec	-2.9	-2.6	74.5	74.1	187	172	268	166	154	-0.3
Sweden	+ 0.98 Feb	+ 13.6	+ 5.6 Jan	2.1	2.1	76.2	84.4	10.32	8.61	14.8	9.18	8.47	3.4
Switzerland	+ 0.17 Feb§	– 0.8	+ 31.1 Q4	11.8	11.2	108.4	104.4	1.72	1.63	2.47	1.53	1.41	na
United States	– 39.50 Jan	– 455.2	– 434.9 Q4	-4.3	-4.1	119.7	107.5	–	–	1.43	0.89	0.82	2.3
Euro area	– 6.94 Jan§	– 9.3	– 33.7 Jan	-0.2	-0.1	79.8	79.6	1.12	1.05	1.61	–	0.92	0.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*												
Finland	+ 1.14 Jan§	+ 13.4	+ 9.5 Jan	na	na	78.6	77.0	6.59	6.16	9.45	5.86	5.41	4.0
Greece	– 1.80 Q3	– 7.2	– 7.8 Oct	na	na	57.6	58.3	378	347	542	336	310	-1.0
Iceland	– 0.01 Feb§	– 0.5	– 0.9 Q4	na	na	na	na	92.7	73.3	133	82.4	76.1	2.8
Ireland	+ 2.47 Dec	+ 25.9	+ 0.2 Q3	na	na	88.0	87.1	0.87	0.82	1.25	0.77	0.71	5.6
Luxembourg	– 0.18 Dec§	– 2.4	+ 1.6 Q3	na	na	99.3	98.9	44.7	41.8	64.1	39.7	36.7	na
New Zealand	+ 0.18 Feb§	– 0.4	– 2.6 Q4	na	na	78.3	86.7	2.47	1.99	3.54	2.19	2.02	0.5
Norway	+ 2.29 Feb	+ 26.2	+ 22.5 Jan	na	na	94.1	92.3	9.06	8.44	13.0	8.05	7.43	14.0
Portugal	– 1.32 Dec§	– 14.9	– 10.4 Jan	na	na	89.6	89.1	222	208	319	198	182	-1.5

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.
§Not seasonally adjusted.

Text refers only to the first 16 countries listed

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STOCKMARKETS

Apr 5th 2001
From The Economist print edition

It was another gloomy week for most stockmarkets. The Nasdaq lost 6.0% on April 3rd, after more high-tech companies issued profit warnings. It finished the week down by 11.6%, to its lowest level since October 1998. The Dow Jones Industrial Average fell by 2.8%.

Market indices	Apr 4th	2001 high	2001 low	% change on one week	% change on one year	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,138.9	3,312.1	3,094.3	+ 0.4	nil	– 5.8	– 0.5	– 12.2
Austria (ATX)	1,175.2	1,219.5	1,052.2	+ 0.5	+ 6.2	– 32.3	+ 9.5	+ 5.2
Belgium (Bel 20)	2,823.7	3,030.4	2,591.6	+ 2.3	– 2.2	– 23.3	– 6.6	– 10.2
Britain (FTSE 100)	5,535.7	6,334.5	5,314.8	– 1.4	– 13.2	– 20.1	– 11.0	– 14.6
Canada (Toronto Composite)	7,415.5	9,348.4	7,415.5	– 1.2	– 19.6	– 34.9	– 17.0	– 20.5
Denmark (Copenhagen SE)	818.3	1,002.1	818.3	– 6.8	– 3.8	– 21.2	– 9.8	– 13.3
France (SBF 250)	3,247.6	3,820.2	3,107.9	– 1.9	– 15.0	– 26.0	– 13.9	– 17.2
Germany (Xetra DAX)	5,597.7	6,795.1	5,388.0	– 3.8	– 23.6	– 30.6	– 13.0	– 16.4
Italy (BCI)	1,677.7	1,948.4	1,609.6	– 0.9	– 11.8	– 23.1	– 12.5	– 15.8
Japan (Nikkei 225)	13,242.8	14,032.4	11,819.7	– 3.8	– 35.3	– 66.0	– 3.9	– 12.4
(Topix)	1,304.4	1,337.6	1,162.0	– 2.5	– 23.0	– 54.8	+ 1.6	– 7.3
Netherlands (EOE)	537.5	642.3	518.3	– 2.8	– 16.1	– 23.4	– 15.7	– 18.9
Spain (Madrid SE)	877.6	963.9	818.6	+ 0.5	– 15.5	– 23.4	– 0.4	– 4.2
Sweden (Affarsvarlden Gen)	219.4§	292.7§	217.2§	– 6.6	– 35.8	– 45.1	– 20.9	– 27.0
Switzerland (Swiss Market)	6,825.4	8,135.4	6,574.0	– 2.0	– 8.9	– 18.9	– 16.1	– 19.7
United States (DJIA)	9,515.4	10,983.6	9,389.5	– 2.8	– 13.8	– 18.8	– 11.8	– 11.8
(S&P 500)	1,103.3	1,373.7	1,103.3	– 4.3	– 25.8	– 27.8	– 16.4	– 16.4
(Nasdaq Comp)	1,638.8	2,859.2	1,638.8	– 11.6	– 60.7	– 67.5	– 33.7	– 33.7
Europe (FTSE Eurotop 300) *	1,327.8	1,545.5	1,279.0	– 2.5	– 16.0	– 22.1	– 13.4	– 16.8
Euro area (FTSE Ebloc 100) *	1,196.0	1,404.1	1,143.9	– 2.1	– 15.3	– 22.9	– 14.1	– 17.4
World (MSCI) †	1,031.5	1,249.2	1,014.6	– 3.2	– 26.9	– 28.8	na	– 16.0
World bond market (Salomon) ‡	433.8	447.8	428.4	– 0.1	– 0.9	– 5.7	na	– 2.3

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms. §Rebased.

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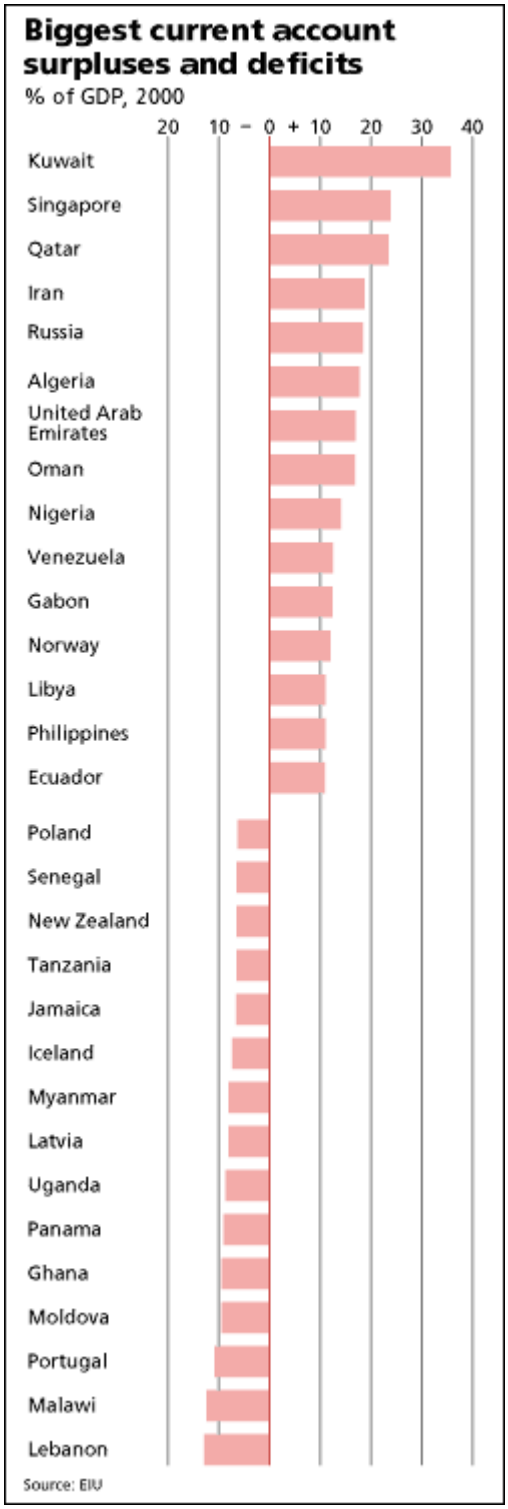
CURRENT ACCOUNTS

Apr 5th 2001
From The Economist print edition

Last year Kuwait piled up the biggest surplus with the rest of the world relative to its national income. The oil-rich country's current-account surplus was equivalent to 36% of its GDP. Our chart shows the most extreme deficits and surpluses among the 117 countries tracked by the Economist Intelligence Unit, a sister company of *The Economist*. The next biggest surplus belonged to Singapore, at around 24% of GDP, followed by a slew of oil exporters headed by Qatar, Iran and Russia. Lebanon built up the biggest debt with the rest of the world, with a current-account deficit of 13% of GDP. The deficits of Malawi and Portugal were nearly as large relative to GDP. Azerbaijan came closest to a balance of zero, with a current-account surplus of 0.1% of GDP.



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FINANCIAL MARKETS

Apr 5th 2001
From The Economist print edition

Turkish shares jumped by nearly 4% on April 4th after the economics minister promised good news soon for the lira. The Turkish lira fell by 10% against the dollar on April 3rd and has fallen by more than 40% since it was floated in February. All the other stockmarkets in the table, save Santiago and Bogota, fell in sympathy with Wall Street.

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Apr 4th		Dec 31st 2000	
	Apr 4th	year ago	Apr 4th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.9	na	2,191.0	− 0.8	− 0.1	− 0.1
Hong Kong	7.80	7.79	11.2	5.04	12,063.7	− 6.1	− 20.1	− 20.1
India	46.6	43.6	66.8	8.75	3,565.7	− 5.9	− 10.2	− 10.1
Indonesia	10,610	7,815	15,207	15.69	367.4	− 2.1	− 11.7	− 19.5
Malaysia	3.80	3.80	5.45	3.30	594.3	−10.1	− 12.6	− 12.6
Philippines	50.1	41.2	71.8	12.03	1,452.2	nil	− 2.8	− 3.0
Singapore	1.81	1.72	2.60	2.50	1,622.0	− 2.0	− 15.8	− 19.6
South Korea	1,368	1,115	1,961	5.87	493.7	− 6.6	− 2.2	− 9.5
Taiwan	33.0	30.4	47.2	4.70	5,405.9	− 7.1	+ 14.0	+ 14.4
Thailand	45.4	38.1	65.0	2.50	279.2	− 2.8	+ 3.7	− 0.8
Argentina	1.00	1.00	1.43	10.19	431.3	− 5.0	+ 3.4	+ 3.3
Brazil	2.17	1.75	3.10	15.85	13,804.1	− 5.7	− 11.5	− 20.3
Chile	597	505	856	4.00*	4,906.6	+ 0.2	+ 0.8	− 3.1
Colombia	2,317	1,969	3,322	12.96	827.3	+ 2.1	+ 16.1	+ 12.0
Mexico	9.43	9.37	13.5	15.38	5,558.0	− 2.5	− 1.7	+ 0.2
Peru	3.52	3.48	5.1	10.80	1,261.0	− 0.6	+ 4.4	+ 4.4
Venezuela	708	671	1,014	12.00	7,210.1	− 2.9	+ 6.1	+ 4.9
Egypt	3.89	3.43	5.57	9.11	6,049.1	− 0.2	− 21.0	− 21.0
Israel	4.21	4.04	6.03	5.51	371.6	− 6.1	− 24.9	− 27.8
South Africa	8.05	6.59	11.5	10.60	7,957.0	− 5.3	− 4.4	− 10.2
Turkey	1,245,000	588,100	1,784,459	77.00	8,117.8	+ 6.6	− 14.0	− 53.7
Czech Republic	38.4	37.6	55.0	5.00	406.7	− 8.4	− 15.0	− 16.7
Hungary	295	268	424	11.35	6,389.1	− 4.5	− 18.6	− 22.2
Poland	4.04	4.22	5.79	17.39	14,197.5	− 4.0	− 20.5	− 18.6
Russia	28.9	28.7	41.4	25.00	161.3†	− 7.0	+ 13.4	+ 12.5

*Inflation adjusted. †In dollar terms.

Sources: National statistics offices, central banks and stock exchanges; Primark Datastream; EIU; Reuters; Warburg Dillon Read; J.P. Morgan; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Bank Ekspres; Deutsche Bank; *Russian Economic Trends*.

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ECONOMY

Apr 5th 2001
From The Economist print edition

A sharp drop in the rupiah precipitated inflation in Indonesia, where annual growth in consumer prices hit a 20-month high in March. Likewise, annual inflation in Turkey rose in March, after having steadily fallen ever since February 2000. Turkey's GDP, however, continued to grow strongly in the fourth quarter, picking up by 8.3% in year-on-year terms.

	% change on year earlier			Latest 12 months, $bn		Foreign reserves*, $bn	
	GDP	Industrial production	Consumer prices	Trade balance	Current account	Latest	Year ago
China	+ 7.3 Q4	+10.2 Feb	+ 1.6 Feb‡	+23.6 Feb	+15.7 1999	168.3 Dec	157.7
Hong Kong	+ 6.8 Q4	− 0.2 Q4	− 2.1 Feb	−11.7 Feb	+ 8.8 Q4	114.3 Feb	93.1
India	+ 6.0 Q2	+ 2.8 Jan	+ 3.0 Feb	− 6.7 Feb	− 5.4 Q4	39.0 Feb	33.5
Indonesia	+ 5.2 Q4	+ 4.5 Q4‡	+ 10.6 Mar	+27.4 Feb	+ 6.1 Q1	22.6 Dec	26.5
Malaysia	+ 6.5 Q4	+12.5 Jan	+ 1.6 Feb	+16.1 Feb	+ 9.7 Q3	29.1 Jan	32.2
Philippines	+ 3.6 Q4	− 2.4 Jan	+ 6.7 Mar	+ 7.3 Jan	+ 8.2 Nov	13.1 Dec	13.2
Singapore	+10.5 Q4	+13.3 Feb	+ 2.0 Jan	+ 3.7 Feb	+21.8 Q4	80.1 Dec	76.8
South Korea	+ 4.6 Q4	+ 8.6 Feb	+ 4.4 Mar	+14.1 Mar	+11.3 Feb	95.3 Feb	79.7
Taiwan	+ 4.1 Q4	+ 9.1 Feb	− 1.0 Feb	+ 9.1 Feb	+ 9.6 Q4	110.1 Feb	113.6
Thailand	+ 3.1 Q4	+ 3.5 Jan	+ 1.4 Mar	+ 4.5 Feb	+ 8.1 Feb	32.2 Jan	31.9
Argentina	− 2.0 Q4	− 0.1 Feb	− 1.7 Feb	+ 1.3 Jan	−10.5 Q3	25.4 Feb	24.7
Brazil	+ 4.4 Q4	+11.2 Jan	+ 5.9 Feb	− 1.3 Mar	−26.4 Feb	32.5 Dec	34.8
Chile	+ 4.5 Q4	− 0.2 Feb	+ 3.5 Mar	+ 1.3 Feb	− 1.0 Q4	14.7 Dec	14.4
Colombia	+ 2.1 Q4	+ 5.0 Jan	+ 8.1 Feb	+ 2.2 Jan	+ 0.2 Q3	9.3 Feb	8.1
Mexico	+ 5.1 Q4	+ 1.9 Jan	+ 7.1 Feb	− 8.7 Feb	−17.7 Q4	39.4 Jan	33.6
Peru	− 1.6 Jan	+ 0.2 Jan	+ 3.6 Feb	− 0.4 Jan	− 1.7 Q4	8.4 Dec	8.7
Venezuela	+ 3.3 Q3	na	+ 12.7 Feb	+ 6.6 Oct	+13.4 Q4	13.9 Jan	12.3
Egypt	+ 6.5 2000†	+ 9.4 2000†	+ 2.3 Dec	−10.4 Q4	− 0.8 Q4	13.1 Nov	15.0
Israel	+ 3.0 Q4	+10.7 Jan	+ 0.3 Feb	− 7.1 Feb	− 0.7 Q3	23.4 Feb	22.1
South Africa	+ 3.3 Q4	+ 5.7 Jan	+ 7.8 Feb	+ 3.4 Feb	− 0.5 Q4	6.1 Jan	6.4
Turkey	+ 8.3 Q4	+ 6.5 Jan	+ 37.5 Mar	−27.1 Jan	− 9.8 Dec	20.0 Dec	23.3
Czech Republic	+ 3.9 Q4	+13.8 Jan	+ 4.0 Feb	− 3.4 Feb	− 2.3 Q4	13.0 Feb	12.6
Hungary	+ 4.2 Q4	+18.5 Feb	+ 10.4 Feb	− 2.4 Feb	− 1.8 Feb	10.8 Jan	11.2
Poland	+ 2.4 Q4	− 0.1 Feb	+ 6.6 Feb	−10.7 Feb	− 9.4 Feb	25.3 Dec	24.5
Russia	+ 7.7 2000	+ 0.8 Feb	+ 22.3 Feb	+61.0 Dec	+43.8 Q3	25.9 Jan	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*						
Pakistan	+ 3.9 1999†	+ 4.6 Jul	+ 4.6 Feb	− 1.9 Jan	− 2.5 1999	1.5 Dec	1.5
Saudi Arabia	+ 0.4 1999	na	− 1.3 Dec	+24.9 1999	+ 0.4 1999	19.6 Dec	17.0

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.

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